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**PRINCIPLES OF  
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# PRINCIPLES OF BANK BOOK-KEEPING

BY  
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*Author of "The Work of a Bank"*



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## PREFACE

CUSTOM decrees that a technical work on banking or its kindred subjects must always be accompanied by a few words of introduction, or possibly justification. Whether this practice is of any value to the majority of readers is a matter of opinion, but inasmuch as a preface forms the only medium whereby an author can pay tribute to the assistance rendered by his friends and colleagues, no excuse is needed for its continued retention.

The purpose underlying the preparation of this work was to indicate the broad principles of bank book-keeping, rather than the detailed examination of certain sections. In this manner it is to be hoped that the book will prove to be of interest alike to bank men and those engaged in other professions.

The author is fortunate enough to enjoy the invaluable help and advice of Mr. W. F. Spalding, whose name is a household word among writers of banking and foreign exchange subjects, and whose enviable record of publications speaks for his popularity as a technical expert. The author based a portion of Chapter XII on an article contributed to the *Bankers' Magazine* by Mr. H. C. F. Holgate (author of *Foreign Exchange Accounts for Bankers*)—an expert on the subject—but he wishes to make it clear that Mr. Holgate is not responsible for the material in its present form. Acknowledgment is also due to Mr. G. A. H. Williams, of Birmingham, for devoting considerable time and trouble towards assisting the preparation of the chapters dealing with branch organization. Finally, the writer is grateful to Mr. G. A. E. Griffiths, of the National Provincial Bank, London, for kindly facilitating the reproduction of many branch forms at present in use, without which no amount of explanatory notes would make the text clear.

LONDON,  
October, 1933.



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# PRINCIPLES OF BANK BOOK-KEEPING

## CHAPTER I

### CONCERNING THE ORIGIN OF BANKING

THE subject of economics has rarely enjoyed such popularity as in the last few years, nor, it may be added has it ever received so many twists in order to shape its theory to suit the particular requirements of the propounder. Since this book is intended to be an explanation of the various entries made by a banker in the course of his business, the reader may well be spared an introductory economic treatise.

The truism cannot be avoided, however, that the banks by the present nature of things are forced to bolster up many languishing industries. Accepting this as a statement of fact and not as a subject for economic debate, the implied strength and solidity of the banks calls for an explanation. In the hope that it will not be considered out of place a brief survey of the progress of banking since its inception is appended. Particular attention is drawn to the gradual evolution of the present co-ordinated system in force in this country.

It is difficult to realize that the modern professional banker had no place in antiquity; such is the appearance of great age and experience that the post-war amalgamations have contrived.

To assert that primitive banking was viewed with the

gravest suspicion and jealousy is to put the case but mildly. The earlier practitioners had no other qualification for money-changing than the possession of considerable wealth. The power of money was felt even in early times, since the acquisition thereof usually endowed the owner with a position of prince or tyrant, according as to whether it was a creditor or a debtor who referred to him. There can be no doubt that if there had been in existence a popular newspaper in those days, much space would have been devoted to analysing the rates of interest charged for loans.

During the Middle Ages the ban put upon usury also militated against the growth of a professional class of banker in this country. The first recorded details show that their development took place in the manufacturing cities of Northern Italy, such as Florence.

The wealthy family of the Bardi were ruined by their loans to our Edward III, while at a later period the world witnessed the rise of the famous Medici family to become princes of Tuscany, chiefly through their financial abilities. This family is probably best remembered from the fact that the pawnbroker's universal sign of the three balls is commonly believed to have been derived from the Medici arms.

In this country the goldsmiths are generally credited with the introduction of a limited system of banking as we know it to-day. They appear to have encountered little competition until William Patterson founded the Bank of England in 1694. Some thirty years later the forerunners of the present powerful organizations made their modest appearance.

The development of banking has been synonymous with the increasing confidence of the public. The word "confidence" is made to cover a multitude of sins,

economic or otherwise, at the present time. Thus it is customary to find the word applied to speculators, traders and others who may be expected by some miracle or other to dispense a mythical tonic to jaded stock markets. Confidence, however, becomes very much a live force when it is considered in connection with the depositing of wealth on trust with another person, and the earlier banks had to pass through an extensive probationary period before their reputations were sufficiently established to wean capital in the shape of deposits from the public.

A study of the growth of banking will reveal that its principles are the outcome of experiments, and that the various laws enacted from time to time are the crystallization of ideas dominant at given periods. The modern intricate system was not constructed without a great amount of labour and analysis. In passing, it should be pointed out that so well were the foundation stones of banking laid that even the crisis of 1931 failed to cause a tremor.

## **FUNCTIONS OF A BANK**

The basic function of any bank is to attract funds from its customers with a surplus, i.e. deposits, and to re-distribute the wealth thus acquired amongst its other customers who have insufficient funds for their needs, i.e. loans. This bald statement would appear to cast the banker for the part of a fairy godmother to all needy individuals; this illusion is summarily dispelled when the question of rates of interest obtrudes. It is, of course, the difference between the rate allowed for deposits and that charged for loans that constitutes the major part of a bank's profits.

A bank may be said to deal in money, inasmuch as

deposits are received and loans granted. In the early days of banking it was necessary for a banker to keep a large supply of coins in a similar manner to any trader stocking his shop. This method, however, had many drawbacks, and steps were soon taken to obviate this keeping of a big money reserve, culminating in the invention of substitutes for legal tender. Such substitutes are known as "representative" money and include cheques, drafts, and bills of exchange. One powerful reason for the rapid extension of the use of these substitutes was the creation of the Clearing system, a full explanation of which will be found in a later chapter. As a result of these developments the modern bank is enabled to work with a comparatively small cash reserve.

It now becomes necessary to sketch the inevitable list of the multitudinous functions performed by the banks of to-day: a number of these call for no special book-keeping entries and will, therefore, be but lightly touched upon in this work.

The appended list, imposing in its length, gives some idea of the service provided by a bank for its customers—

1. Deposits are received either with or without interest according to the category in which they fall.

2. Loans or overdrafts are granted against security of all description.

3. Approved bills of exchange are discounted.

4. Commercial credits are opened on behalf of trading customers.

5. Circular notes, travellers' cheques, and all forms of letters of credit are issued.

6. Stock Exchange transactions are effected.

7. Dividends are received and payments are made on behalf of customers.

8. Securities are received for safe custody ; coupons are detached and collected.

9. The duties of an executor or custodian trustee are undertaken.

10. When new capital issues are made by a company customer, the funds are collected and the shares allotted, if desired.

11. A system of night banking is provided whereby customers may deposit at their own risk cheques, notes and coin, to be placed to their account in the morning.

Despite the expanding scope of British banking, by far the greatest number of book-keeping entries are connected with its basic function. Many of the services provided by the banks entail no more than the recording of a memorandum of the transaction, and the only actual entry arising out of them consists of the charge to the customer for the facility. It is with the conducting of current and deposit accounts and the granting of loans that vast numbers of entries arise, but before proceeding to an explanation of these, it is essential that the organization of the British banking system be understood.

## CHAPTER II

### THE BRITISH BANKING SYSTEM

THE British banking system divides itself into three distinct groups, namely, (a) the Bank of England; (b) the Big Five and other clearing banks; (c) the non-clearing banks. Some of the special characteristics of each group are dealt with in this chapter.

#### THE BANK OF ENGLAND

The keystone of British banking is the Bank of England, which not only performs the functions of an ordinary bank, but acts as the guardian of the nation's resources and its agent in most financial matters. The Bank of England is the appointed custodian of the nation's gold reserve, and is responsible for the whole of the note issue, as provided for in the Currency and Bank Notes Act, 1928. In addition the Bank acts as the Government's agent in connection with the issue or redemption of loans, takes a prominent part in the administration of India's financial schemes, and is the pivot around which the London Clearing House revolves. In effect, the Bank of England is a central bank without the political control that this description implies.

Sufficient has been said to illustrate the great power and trust placed in the hands of the Bank of England, a fact, it must be added, which would be intolerable if that institution was not free from the taint of political bias and influence. No other bank in the world enjoys such immunity from suspicion as the Bank of England, which is a tribute to its history and organization.

## CLEARING BANKS

Grouped around the principal bank are to be found the clearing banks, headed by the Big Five; these institutions having been created as a result of the series of amalgamations that took place towards the end of the war and in subsequent years. This merging of assets began to assume such vast proportions that the Government deemed it necessary to legislate on the question, and consequently no further fusion can take place without the consent of Parliament. At the point when the process was legally curtailed, there were five powerful groups left to compete, one with another, for the privilege of acting as the public's banker.

It has taken a considerable number of years to merge the various units into a smoothly run machine, but the last era witnessed the full benefits extracted from the policy, culminating in the crisis, when by joint action immediate precautions were taken to safeguard the depositors' funds.

The Big Five each possess a chain of branches throughout England and Wales, thus enabling them to collect the resources of the whole country in the form of deposits and to distribute the proceeds by means of loans through the same channels. The great advantage of the British system of banking is that it lends itself more readily to the adoption of a certain policy, particularly in regard to such questions as the proportion of liquid assets it is desirable to maintain. Also, it enables the Government of the day to retain greater control over the monetary situation by adopting through its agent, the Bank of England, measures for the facilitating of national plans.

Contrasting this system with that of the United States of America, we see that a higher degree of security is



afforded by our branch organization with a central control than the American method which consists of a vast number of separate entities owing allegiance to no leader. It may be argued that competition is more developed under the latter scheme, but this advantage is diminished by the unhappy experience in times of adversity, when lack of concerted action results in a large number of individual failures.

The creation of the Big Five banks has tended towards uniformity in banking practice, there being but slight difference in the book-keeping entries of each member. Since by far the greater part of the deposits received may be withdrawn on demand, it follows that a proportion of a bank's assets must be liquid. This is achieved by keeping an account at the Bank of England and by short loans to the money market. The Bank pays no interest on deposits; the balance kept there by another bank is therefore a frozen asset where profit-earning is concerned.

When provision has been made for the essential liquid proportion, a bank is then free to employ its remaining assets to the most profitable advantage compatible with security. Here, again, tradition points to certain courses through which the stream of capital may be released from the reservoir. Thus it will be found that part of a bank's funds will be locked up in gilt-edged stocks, earning a regular dividend and not subject to fluctuations, seasonal, or otherwise, affecting the more speculative investments.

British railway stocks and other trustee securities also receive a considerable amount of attention when a banker is contemplating investment.

A further method of employing funds is provided by the discount market. Treasury bills and first-class commercial bills form a sound investment from a banking

point of view, particularly as it is a simple matter to arrange for the maturity dates of the bills purchased to coincide with any known disbursements that a bank may expect to make in the future.

The Bank of England, on behalf of the Treasury, issues a supply of treasury bills every Friday; to acquire them it is necessary to submit a tender stating the amount required over the official minimum of £50,000, and the rate of discount offered. The other banks arrange their tenders according to the funds at their disposal and to suit any special requirements at the maturity date. Should they fail to secure their full quota, resort is had to the market, which consists of a number of old established bill-brokers, to make good the deficiency. This procedure does not satisfy completely a bank's investment demand for bills, since it may be desired to employ money available early in the week, so in order to obviate the necessity of waiting until the next week's tender, bills with a shorter period to run before maturity are purchased from the brokers.

In practice, the bill-brokers call at the banks every morning to ascertain their requirements in respect of bills, and their wishes in regard to the short loans renewable from day to day. For a full description of this interesting phase of banking the reader is referred to a work which is devoted to an exhaustive survey of the subject.<sup>1</sup>

So far we have discussed the channels through which the big banks can employ proportions of their assets for more or less definite periods. Doubtless, it will also have been noticed that up to the present, surplus funds have been allotted to specialized quarters. It is now the turn of the ordinary customers of a bank to claim attention.

<sup>1</sup> *The London Money Market*, by W. F. Spalding. (Pitman.)

Advances to ordinary customers constitute by far the biggest item on the assets side of a bank balance sheet. The expression "ordinary" customer includes both private individuals and limited companies. Money is advanced in two ways, either by means of a loan on loan account, or an overdraft on current account, the former method being employed when the customer desires to have full use of the whole amount at once, and the latter when overdraft facilities are required up to an agreed limit spread over a definite period, e.g. six months. With a loan, interest begins to run on the full amount as soon as the loan account is opened in favour of the customer; on the other hand, interest on an overdrawn account will only be charged on the outstanding balance and not on the full extent of the overdraft limit.

In regard to the type of security taken it is not possible fully to discuss the subject in a book-keeping work, but an outline of the considerations a banker must be prepared to weigh up may be helpful. Needless to say, it is impossible to achieve uniformity when deciding whether the security offered is adequate. Such questions as the standing of the customer, connected accounts, conditions ruling in a certain trade or industry, general economic conditions, matters of policy and other special problems have to be investigated before a decision is reached.

Apart from these considerations the following types of security find favour with the banks. Evidence of ownership of land, e.g. title deeds; the various documents of title to stocks and shares of well reported companies; warrants, bills of lading, etc., relating to the possession of goods; guarantees by third parties; British Government and foreign states' issues; life insurance policies and debentures created in favour of the bank. No attempt is made here to indicate the merits or demerits of a particular

class of security, but this much can serve as a guidance—the best security for purposes of an advance is one which can easily be conveyed to the bank, requires no action from the bank during its ownership thereof and is readily converted into cash.

### OTHER BANKS

Encircling the inner ring of clearing banks is another ring of smaller institutions consisting chiefly of the exchange banks, London offices of the Scotch and Irish banks, branches of colonial and foreign organizations and the merchant bankers.

The Scotch and Irish branch banks conduct a flourishing business on the same lines as a clearing institution, many companies with connections in Scotland and Ireland finding it convenient to transact part, if not all, of their banking business with these offices. The remarks apropos the clearing banks can be extended to include these banks, who operate within a smaller range on the same principles.

The main function of the other institutions is not usually the acquisition of deposits for a short period—competition from the Big Five is too strong for that—but to attract fixed deposits, i.e. deposits for an agreed period. The essential feature of a fixed deposit is that it is understood that the bank shall enjoy complete use of the funds until the term of the fixture expires. In order to compensate the depositor for his inability to withdraw any part of the deposit before the expiration of the fixed period, a higher rate of interest is paid. It will be seen later in this chapter why it is necessary for the exchange banks to retain control of its deposits for a longer period than the clearing banks.

Every banking office in London carries on the ordinary

business of a bank to a greater or less extent, including the conducting of current accounts. Cheque books are issued and any branch of the Big Five will receive such cheques for collection.

It has been asserted that the main function of a non-clearing bank lies in affording its customers credit facilities. There are a considerable number of recognized methods for establishing a credit. Should a credit be required for a private individual a travelling letter of credit would probably satisfy his needs: this enables him to cash on demand drafts on the issuing bank at any of the latter's branches or correspondents throughout the world.

It is not with individuals, however, that the bulk of an exchange or foreign bank's credit arrangements is transacted.

International trade is financed almost invariably through the medium of a bank credit in some shape or form. The *modus operandi* consists of the importer of goods approaching his bank with a view to their opening a credit in favour of the exporter supplying the goods. If the bank agrees to the proposition a letter of credit is drawn up, authorizing the exporter to draw drafts on the issuing bank up to the amount involved at a stated usance agreeable to all parties to the contract. The credit will also describe the conditions of shipment, etc., and the documents required to be attached to the bills, unless it be a clean credit. The terms of the credit can be communicated to the exporter either by mail or by cable. Should he be satisfied with the contents, he proceeds to ship the goods, obtains the necessary documents, and draws his drafts.

The main object of obtaining a credit is now revealed. The exporter, having drawn his draft, attaches the documents and a copy of the credit requirements and takes the complete dossier to his own bank. The latter will be

asked to purchase or negotiate the drafts; the general practice being for the bank to retain a percentage of the amount of the drafts until advice is received of their payment. In any case a right of recourse accrues to the bank over any money advanced, should the drafts be refused payment. It is necessary, of course, that the bank satisfy itself that the draft and documents are in order before purchasing the bill from the exporter.

The negotiating bank remits the draft to its branch or agent in London, for presentation to the bank on which it is drawn. The latter compares the documents closely with the stipulations of the credit, checks the details of the draft, and, if satisfied, seals the transaction with its acceptance.

The benefits conferred on international traders by the issue of commercial letters of credit will be apparent at once. Exporters secure an immediate return for their goods, whereas many weeks might elapse if they had to wait until the goods arrived, plus the usance of a draft drawn on the importer. Importers, on the other hand, can deal with the goods some time before it is necessary for them to put the issuing bank in funds to meet the acceptance. Thus, in most cases, the proceeds from resales can be applied towards payment of the draft, a practice which preserves capital intact and enables the importer to take his margin of profit without any locking up of usable funds. Taking a wider outlook, the use of bank credits permits of an expansion of trade, lowers production costs, and increases confidence.

The example given is but one of many varieties of bank letters of credit in use, but it was chosen in preference to others since it affords a more striking illustration of the advantages to be gained by the system.

It will be apparent, therefore, that the exchange and

foreign banks perform a very useful service in consolidating the employment of credits for both commercial and private transactions. Credits were originally instituted by the old merchant bankers, and they still retain a considerable proportion of this class of banking business by virtue of their long record of unimpeachable integrity, to which London in a great measure owes its pre-eminence in the financing of world trade.

These non-clearing banks form one of the main sources of supply for the bill market. They receive a great number of bills from their head offices or branches drawn under London credits and requiring acceptance. This is obtained and the bills are then offered to the brokers on the London market, who may buy them to re-sell to the clearing banks or to retain in their portfolios in the expectation of a greater profit in the near future.

Generally speaking, the merchant banks and other non-clearing banks have maintained a closer connection with colonial and foreign countries than the members of the Big Five. For this reason their functions differ from those of a domestic bank, inasmuch as they undertake services arising out of international trade and its settlement, including the shipment of gold or silver; foreign travel; the service of loans raised in this country by other nations or states; and the operation of the market for the currency of the country they represent.

A glance at these functions will reveal the fact that the majority of them entail the locking up of the bank's assets for a considerable period. It is for this reason that the exchange banks prefer "fixed" deposits rather than deposits liable to be withdrawn suddenly.

This outline of the present system of banking in this country is necessarily incomplete, but, at least, it is hoped that the reader has been provided with sufficient

material to understand the objects that bank book-keeping is designed to fulfil. Accordingly, we hasten to commence the study proper of the entries a bank makes, confident that their very simplicity will bridge any gaps that occur in this chapter.



## CHAPTER III

### THE EVOLUTION OF BANK BOOK-KEEPING

FOR many years the subject of book-keeping was held to contain untold mysteries for the ordinary person, and it was left to the wizards of finance to indulge their unnatural gifts by exploring the possibilities of a more uniform system of making entries. Yet, most people adopted some form of book-keeping even if it was only the occasional recording of expenditure of their weekly wage. The days when it was regarded almost as a mark of distinction to be completely ignorant of figures, and their manipulation, have disappeared, book-keeping to-day holding a foremost place in the realms of commerce.

The reason for this *volte-face* on the part of the business community can be directly traced to the growth of the big companies, with far-flung activities and enormous turnovers. The day of the private trader has gone and in his place we have the branch shop of one of the great combines. Likewise, the private banker has disappeared and the joint-stock banks reared up in his shoes.

We have seen that banking was originally a side-line of wealthy merchants and subsequently became part of a goldsmith's activities. It may be assumed that early transactions of a banking nature were recorded under a primitive system of accounting, but this was altered when the goldsmiths arrived on the scene. To illustrate the system they adopted to record the operations on a customer's account, the account of Samuel Pepys is appended.<sup>1</sup>

<sup>1</sup> By kind permission of Messrs. Hoare & Co.

This historic account is the only one of its kind known to exist, and is contained in the earliest ledgers in Messrs. Hoare's possession—

| SAMUELL PEPYS ESQ is Dr |   | £   | s. | d. |
|-------------------------|---|-----|----|----|
| Jan 18                  | By £017: paid Mrs. Hollinshead p. note  |     |    |    |
| 1680                    | from Dr.                                | 17  | —  | —  |
| Febr 19                 | „ £010. 15 paid Dr p. his rect          | 10  | 15 | —  |
| Mar 9                   | „ £005 paid Mr Moses Pitty p. note      |     |    |    |
|                         | from Dr                                 | 5   | —  | —  |
| „ 9                     | „ £010. 15 paid Dr p. his rect          | 10  | 15 | —  |
| „ 17                    | „ £014. 0 paid Mr Edw Holinshead for    |     |    |    |
|                         | Mr Holinshead p. note from Dr           | 14  | 00 | 0  |
| Apr 11                  | „ £010. 16. 8 paid p. his rect          | 10  | 16 | 8  |
| „ 13                    | „ £008 paid Mr Godfrey Richards p. note |     |    |    |
|                         | from Dr                                 | 8   | —  | —  |
| May 2                   | „ £12. 16. 8 paid Dr p. his rect        | 12  | 16 | 8  |
| June 11                 | „ £10. 16. 8 paid Dr p. his rect        | 10  | 16 | 8  |
| „ 20                    | „ £12. 18. 0 paid Dr p. his rect        | 12  | 18 | —  |
| Aug 13                  | „ £07 paid Mr Robert Hasellwood p. note |     |    |    |
|                         | from Dr                                 | 7   | —  | —  |
| „ 20                    | „ £24. 10 paid Mr Robert Scott p. note  |     |    |    |
|                         | from Dr                                 | 24  | 10 | 0  |
| „ 26                    | „ £30. 0 paid Lady Bernard p. note from |     |    |    |
|                         | Dr                                      | 30  | 10 | 0  |
| Sep 26                  | „ £16. 05. 0 paid Dr p. his rect        | 16  | 05 | 0  |
| Nov 9                   | „ £15. 16. 8 paid Dr p. his rect        | 15  | 16 | 8  |
|                         | „ £10 paid Dr on the 29 of January last | 10  | —  | —  |
| SAMUELL PEPYS ESQ is Cr |   | £   | s. | d. |
| Dec. 13                 | ffor £200 recd of Cr. p. note           | 200 | 0  | 0  |
| 1680                    |   |     |    |    |

Judging from these entries it would appear that a person of standing would be allowed to settle his debts by issuing notes on his banker, the latter expecting to be recompensed at intervals. No indication is given as to the charge for this accommodation.

A few years after the date of the ledger entries in the illustrations, the Bank of England started on its successful fight for existence, and early in the nineteenth century the

forerunners of the present banks made their appearance. Confidence gradually being inspired by these banking houses, the custom of leaving coin for safe custody gradually yielded to the more advantageous method of leaving it on account.

That it was desirable to maintain a careful system of entries was quickly realized, the bankers encouraging the practice of a merchant bringing his own book of record to the bank, and ticking up the debits and credits at the bank's counter, agreeing the outstanding balance at the same time. The name given to the merchant's book of account was the "passage" book, and from this word is derived the modern abbreviation of pass book. This method of agreeing entries had a grave disadvantage from the banker's point of view when the number of his customers increased. Obviously, a banking counter completely occupied by merchants ticking up their entries was not calculated to appeal to a private customer bent on ordinary banking business. It was soon apparent that the only solution was to issue a pass book to each customer, containing a full record of all transactions on his account and written up preferably from the aspect of the bank in account with the customer.

It seems difficult to think of banking being carried on without notes and cheques, and a modern bank-clerk might well wonder what there was to do in the days when all transactions took place over the counter. It must be realized, however, that the first conception of banking was to enable a person to deposit specie for safe custody. Loans to customers were only indulged in after it was found by experience that a considerable proportion of a bank's deposits was left idle on his hands. By offering interest on deposits and subjecting them to notice of withdrawal, the bankers were enabled to obtain the use

of such funds. It was then that bank book-keeping began to assume a more technical aspect.

Hitherto, a banker could condense his entries into a cash journal, ledger and pass book. Under the new innovation it became necessary to sub-divide the ledger into current (or drawing) accounts and deposit accounts. In the latter a column for interest had to be included, and the rate to be allowed was usually inserted, since the idea of a flat rate was as elastically adhered to then as it is to-day.

Again, when the bankers started to lend money, further additions had to be made to the number of books employed. Loan ledgers were brought into use and contained precisely the same information as they do to-day. In those early days, however, loan transactions like every other form of banking business were not very complex. A few customers would borrow loans against what to-day would be regarded as extraordinary security; very often their word to repay was all that was considered necessary. There was no such thing as loans to stockbrokers, bill-brokers, and other specialized sources, which form a feature of present-day banking. Entries, therefore, in connection with loans could easily be recorded in the cash book as a payment out and in the loan ledger as a debit to the account.

Bank book-keeping began to assume large proportions with the introduction of the cheque as a means for withdrawing money on account with a bank. The popularity of the innovation was such that drastic changes had to be made in banking procedure and the perfecting of the clearing system came as a welcome relief to harassed clerks. The foundations of the present system of bank book-keeping were laid when the banks adapted their methods to cope with the greatly increased number of entries caused by the invention of cheques.

The original members of the London Clearing House consisted of an exclusive circle of private bankers, and some years elapsed before they surrendered to the inevitable and admitted the joint stock banks to membership. Even this concession did not solve the latter's problem of how to eliminate the waste of time and labour required to enter cheques by hand and to cast long lists of amounts.

Everyone, nowadays, has heard, if not used, an adding machine, but in those days such facilities did not exist. It is not an exaggeration to say that, if the adding machines at present employed in the banks were put out of action, cheques would take at least twice as long to clear.

The present system of book-keeping relies to an increasing extent on machines. This is not surprising when the multiplicity of entries involved in banking is considered. Banking may be said to constitute an ideal enterprise for the employment of mechanized book-keeping, since the majority of entries are standardized and arise from the same function, the collection and payment of cheques.

The adding machine quickly became a prominent feature in the main offices of the banks, and most of their branches were equipped with at least one model. The advantages of this invention are obvious; the margin of error was reduced, while there was increased speed of recording the entries, and more staff available for other functions of banking. On the other hand, the old type of adding machine had the disadvantage of facilitating the book-keeping system, but not being an integral part thereof. To illustrate this point, attention may be drawn to the fact that when such machines were first employed their scope did not extend beyond the agreeing of a total for

a batch of cheques. The machined list of entries was destroyed, and the cheques were then entered throughout the various waste books, ledgers, etc.

The application of machines to the Clearing System was an exception to the general rule, inasmuch as the machined lists were kept as a record of cheques, received from or presented to another bank. The clearing system, however, is a highly specialized branch of book-keeping, and can hardly be termed part of a bank's internal accounting.

The process of mechanization was carried a step further in recent years by the introduction of a machine which combined the essential characteristics of an adding machine and a typewriter. The success of this new machine has again completely altered banking procedure. To mention but one important change, the recording of banking entries is now made on the loose-leaf system of book-keeping, whereas in the past it was necessary to keep a large reserve of bound books for journal and ledger entries.

The adoption of the new machine has obviated the disadvantage appertaining to the old adding machine, since it is now possible to machine waste, cash and ledger entries, using the loose sheets as a permanent record.

Without entering into the controversy over the mechanization of the banks, certain disadvantages of the new machines should not be overlooked. The first is that only one person can work the machine at a time, and when a rush period occurs waste and ledger entries are exceptionally numerous. Under the old system it was possible to detail additional staff to concentrate on posting these entries in the various books, but this is impossible with a machine. This contention can be answered with the rejoinder that the time saved over the

entries under normal pressure far outweighs the loss during a rush period.

The other disadvantage is that the new machines are so costly that only branches over a certain size can be equipped with them. To the ordinary person it may seem rather extraordinary that one branch of a bank records all its cheque entries by machine, whereas another branch does not possess either a typewriter or an adding machine. The explanation is that the banks are at present working under a blending of the two systems, and in doing so they admit that the scope of the present day machines is limited. They have adopted the loose-leaf system throughout the whole of their organizations, but at present too many difficulties exist to justify the costly outlay required to standardize all branch entries.

It must not be imagined that any grave inconvenience is caused to a bank through the operation of two different methods of book-keeping. All entries made at a branch are ultimately conveyed in summarized form to head office, and as long as such figures are accurate the method of obtaining them matters not at all to those responsible for head office book-keeping. Further evidence of this fact can be found on reference to the many amalgamations that took place. The process of uniting two or more different systems was carried through with a minimum of upheaval, and although it could not be expected that the perfect blending be achieved immediately, no basic alteration has subsequently been found necessary.

The condensing of domestic banking into the big institutions has necessarily rendered bank-bookkeeping in this country singularly free from variation, particularly in the case of head office entries.

Head office deals with the figures of the bank as a whole and its entries are not concerned with customer's accounts

directly, but only with a summary of operations taking place in any particular office. The object of head office book-keeping is to enable those in control to dispose of the bank's assets as outlined in the previous chapter. Thus, should the total of deposits fall, arrangements must be made to preserve the correct proportions by reducing advances and the cash reserve. Other important features of head office will be explained from time to time, but at present it is only necessary to emphasize the strictly internal nature of the entries with the single exception of settling agency accounts with other banks.

A clearing bank compiles a weekly statement of its position from returns received from branches. Before these returns can be dispatched to head office, all the ledger balances must be taken out and agreed, as explained in the chapter dealing with branch accounts. In connection with the weekly statements it is of interest to notice that the newspapers very often refer to window dressing by the banks, in their money market columns. The window dressing referred to is a practice of the clearing banks to call in short loans from the bill brokers on the day the weekly balance takes place. The proceeds thus obtained are allowed to rest in the bank's account at the Bank of England overnight, earning no interest for that period, but revealing a much stronger cash reserve for possible withdrawals, since the balance at the Bank constitutes the major part of the provision for outgoings of the ordinary bank's assets. The purpose of this window dressing is achieved by allowing the cash proportion to remain high overnight, since the weekly statement is compiled from the figures at the close of business on the balance day; the next day, therefore, short loans will again be plentiful in the money market.

In early times the administrative side of banking looked



after itself, and called for very little in the way of special preparations. When deposits began to increase the bankers found themselves faced with added responsibilities, and it must be said that these were not always satisfactorily fulfilled. Such a water-tight system as administered by the banks of to-day was not constructed without many lessons in the hard school of experience. Especially do these remarks apply to the proportional method of distributing a bank's resources, and its closely allied function of forecasting possible withdrawals on a large scale. A survey of the history of banking up to post war years will show that failures of banks were fairly numerous, and disturbances, such as the banking crisis of 1890, had the power to send repercussions throughout the banking community. If this is contrasted with the amazing solidity presented by the banks during the crisis of 1931, it will indeed be realized the banking has amply profited by the lessons of the past, a position due to a great extent to the improvement and progress in book-keeping methods.

It is a far cry to the old days when merchants brought their passage books to the banks, and it is an interesting speculation whether the neatly machined statements of to-day will be as completely out of date in the next century.

## CHAPTER IV

### THE BANK OF ENGLAND

THE unique functions of the Bank of England have already been noted, and it is now necessary to examine the methods adopted to deal with the nation's accounts and the accounts of other banks. In pursuing this aim it must not be overlooked that the Bank transacts an ordinary banking business of its own in regard to conducting accounts for its customers, but this side of its activities is necessarily overshadowed by the importance of national finance.

The Bank of England operates under a Royal Charter, originally granted in 1694 in return for a loan to the State of £1,200,000, which was the whole of its initial capital. Interest was paid on this loan at the rate of 8 per cent, and as a further consideration, a monopoly of joint-stock banking was conferred upon the bank.

Subsequent Acts of Parliament confirmed the position of the Bank of England as the central bank, while the Bank Charter Act of 1844 instigated the scheme upon which the monetary position of this country has been based.

#### **BANK CHARTER ACT, 1844**

The provisions of this Act have been subject to severe criticism in the past, chiefly on account of the fact that the Government was forced to suspend the Act on no fewer than three occasions in the latter part of the nineteenth century. A survey of the events leading up to these suspensions would appear, however, to indicate that the

bankers were still undergoing a probationary course in the managing of the country's credit position, and it was due more to lack of technical experience rather than any shortcomings in the Act that caused the crises to arise.

The main provisions of the Act of 1844 were—

1. The issue and banking departments were to be kept separate and an account for each department rendered each week. This became known as the Bank Return.

2. The issue department was made responsible for all the Bank's notes in circulation at that time, and against this liability was to be held the Government's debt of £11,015,100 (the sum to which the original £1,200,000 loan had risen), together with a further sum, in securities, of £2,984,900. Thus, at that date, the total of notes issued against securities amounted to £14,000,000, and this was called the fiduciary issue. In fixing the sum of £14,000,000 the sponsors of the Act were guided by the fact that for many years antecedently to that time, Bank of England notes in circulation had not fallen below sixteen million pounds, and, as it was assumed that in any future panic the notes in the hands of the public were not likely to be reduced below fourteen millions, this latter amount was agreed upon as the limit the bank might issue notes against securities. Any notes issued in excess of this amount had to be backed by gold and silver, the silver not to exceed one-fifth of the whole.

3. It was also provided that upon any of the provincial banks ceasing to issue notes, the Bank of England might, by order in council, further issue against securities notes to the amount of two-thirds of those which the withdrawing provincial bank was authorized to issue. In this way the fiduciary issue was raised from £14,000,000 to £19,750,000.

## THE CURRENCY AND BANK NOTES ACTS OF 1914 AND 1928

The earlier Act extended the issue of bank notes to include an issue by the Treasury of currency notes of £1, and 10s. Hitherto, the Bank of England had only issued its own notes of £5 and upwards, but now the Treasury notes were circulated through the medium of the Bank. This innovation marked the beginning of the disappearance of gold coins from circulation.

The Act of 1928 amalgamated the Treasury note issue with that of the Bank of England, the latter being constituted the responsible party for the whole of the note issue in this country. This step involved an alteration in the fiduciary issue limit and the following procedure was adopted—

In accordance with the recommendations of the Cunliffe Report, the Treasury had hitherto followed the practice of constituting the actual maximum fiduciary issue reached one year to be the allowed maximum of the next. The maximum of 1927 was £244·94 millions. To this figure was added the Bank of England fiduciary note issue of £19·75 millions, making £264·69 millions.

Allowance had also to be made for the amount of Treasury notes in circulation in the Irish Free State, since the latter substituted their own notes about that time. This allowance was roughly estimated at £6,000,000, and reduced the total to £258·69 millions, which was brought up to the round figure of £260,000,000.

Provision is made in the Act for increasing or reducing this fiduciary limit with the consent of the Treasury and subject to any conditions it imposes. The limit can only be raised for two years on Treasury sanction, however,

and if an increase is desired for a longer period the consent of Parliament must be sought.

The Act required the Bank to hold securities against the fiduciary issue, and the Treasury was authorized to transfer the securities held at that time against the notes outstanding. Up to a limit of £5,500,000 the Act allowed silver coin to be held as a security, but this figure is being steadily reduced and will eventually disappear.

The Currency and Bank Notes Act of 1928 returned to the principles of the Bank Charter Act of 1844, with the necessary adjustments, for providing the nation with an adequate volume of currency and for maintaining its value stable.

## **BANK RETURN**

With this outline of the legal provisions to which the Bank of England must conform in managing the currency and credit of this country, the moment is opportune for a study of the weekly return it renders (see p. 29).

Before examining the items of the return in detail, the attention of the reader is drawn to the amount of the Fiduciary Issue as contained in the specimen account. It has been explained that the fiduciary limit fixed by the Currency and Bank Notes Act, 1928, was £260,000,000, whereas at present it appears as £275,000,000.

Reverting once again to the crisis of 1931, it will be recalled that the Bank of England made desperate attempts to keep this country on the gold standard, even to the extent of shipping gold. Eventually the supply of gold, or in other words, the basis of credit became so depleted that an inevitable deflationary position was faced by the Bank. The only method of avoiding a big drop in the note circulation with the attendant disturbance of internal price levels was to

COPY]

**BANK OF ENGLAND**

AN ACCOUNT for the Week ended on Wednesday, the  
18th day of January, 1933

**ISSUE DEPARTMENT**

| $\pounds$               |                     | $\pounds$              |                     |
|-------------------------|---------------------|------------------------|---------------------|
| Notes Issued:           |                     | Government Debt .      | 11,015,100          |
| In Circulation .        | 354,663,728         | Other Govt. Securities | 255,228,147         |
| In Banking Department . | 40,129,851          | Other Securities .     | 5,041,120           |
|                         |                     | Silver Coin .          | 3,715,633           |
|                         |                     |                        | <hr/>               |
|                         |                     | Amount of              |                     |
|                         |                     | Fiduciary Issue.       | £275,000,000        |
|                         |                     | Gold Coin and Bullion  | 119,793,579         |
|                         |                     |                        | <hr/>               |
|                         | <u>£394,793,579</u> |                        | <u>£394,793,579</u> |

*Dated the 19th day of January, 1933.*

B. G. CATTERNS, *Chief Cashier.*

**BANKING DEPARTMENT**

| $\pounds$   |                     | $\pounds$            |                     |
|---|---------------------|----------------------|---------------------|
| Proprietors' Capital .  | 14,553,000          | Govt. Securities .   | 96,552,390          |
| Rest . . . . .  | 3,526,534           | Other Securities:    |                     |
| Public Deposits—  |                     | Discounts and        |                     |
| (including Ex-<br>chequer, Sav-<br>ings Banks, Com-<br>missioners of<br>National Debt,<br>and Dividend<br>Accounts) | 12,116,196          | Advances—            |                     |
|   |                     | £11,819,357          |                     |
| Other Deposits:   |                     | Securities—          |                     |
| Bankers—  |                     | £18,803,995          |                     |
| £105,380,987  |                     |                      | <hr/>               |
| Other Accounts—   |                     | Notes . . . . .      | 30,623,352          |
| £32,504,416   |                     | Gold and Silver Coin | 40,129,851          |
|   |                     |                      | 777,075             |
|   |                     |                      | <hr/>               |
| 7 Day and Other Bills   | 1,535               |                      |                     |
|   | <hr/>               |                      |                     |
|   | <u>£168,082,668</u> |                      | <u>£168,082,668</u> |

*Dated the 19th day of January, 1933.*

B. G. CATTERNS, *Chief Cashier.*

increase the fiduciary limit. Accordingly, on 1st August, 1931, the Treasury granted the Bank's request for an increased fiduciary limit of £275,000,000, which was subsequently confirmed every six months, until it was allowed to lapse on 31st May, 1933. On this date the fiduciary issue was reduced to its former level of £260,000,000.

**Issue Department.** This part of the return is exclusive to the note issue and will be found to contain the information relative to the note issue.

The left-hand side of the return shows the amount of notes in active circulation and those held in the banking department. The aggregate value is the result arrived at after amalgamating the Bank's original issue with the Treasury issue taken over.

The right-hand side of the return reveals the assets held against the liability of notes issued. These comprise—

1. *Government Debt.* This represents the original loan to the Government by the Bank as specified in the Bank Charter Act.

2. *Other Government Securities.* These are the assets transferred from the Treasury to constitute the backing to the increase in the fiduciary issue.

3. *Other Securities.* This item represents the remaining investments held against the note issue, and consists of securities other than those of the British Government but nevertheless first-class. The Currency and Bank Notes Act, 1928, permitted the Bank to include commercial bills as an asset against the fiduciary issue, and presumably the undisclosed proportion of bills held under this heading varies from week to week, since the discount market forms a convenient medium for the increase or reduction of accumulated funds.

4. *Silver Coin.* This item consists of the balance of

assets required to support the fiduciary issue. It will be noticed that the amount of silver coin is well within the limit of £5,500,000 imposed by the Act on the occasion of its transference from the currency note redemption account.

5. *Gold Coin and Bullion.* The amount of this item is of the utmost importance to the country as it represents the basis upon which the national credit is constructed. So much has been written about the subject of gold that we will content ourselves by stating here that the Bank can issue notes, pound for pound, against the gold it holds, and on the 18th January, 1933, the notes the Bank could issue in this manner amounted to £119,793,579.

**Banking Department.** The left-hand side comprises—

1. *Proprietors' Capital.* This remains at the figure reached in 1816.

2. *The Rest.* This item may be given the title of the Bank's domestic reserve, since it represents undistributed profits. It is the practice of the Bank never to let this amount drop below £3,000,000.

3. *Public Deposits.* Hitherto, it has been stated that the Bank acts as the Government's bank and financial agent. This requires a fuller explanation. A common fallacy exists in associating anything connected with national finance as being held on behalf of the Treasury. Actually the Treasury does not have possession of all national funds, but it controls their movements. Thus, this item will include balances standing to the credit of the many Government Departments, as well as the accounts indicated in the return.

4. *Other Deposits.* Bankers. This includes the balances maintained by the ten clearing banks and the smaller sums deposited by the other banks. Such deposits are included amongst the various banks' assets as cash.



*Other Accounts.* The separation of the deposits into two classes was an innovation introduced at the time the Bank took over the Treasury note issue. Under this heading would be found deposits by the Bank's own private customers both at home and abroad. No interest is paid on either class of deposit.

5. *Seven Day and Other Bills.* This item is a survival of the eighteenth century when these drafts, drawn by head office on a branch, or *vice versa*, or by one branch on another, were used as a preventative against loss in high-way robberies.

On the right-hand side of the return the following items appear—

*Government Securities.* This amount represents the security of a gilt-edged character held by the Banking Department against its liabilities. Included in this item would be Consols, War Loan, and Securities made over to the Bank by the Treasury against temporary advances required to meet obligations that must be settled in advance. Such loans are known as Ways and Means Advances and Deficiency Advances.

*Other Securities.* Discounts and Advances. It is commonly believed that the amount shown under this heading represents the accommodation granted to the money market upon application by the bill-brokers and discount houses. It is important to notice that the Bank does not necessarily take the initiative in giving such loans; usually it operates through its own brokers when it desires to influence the market by increasing or decreasing the supply of bills. Generally speaking, the market is "forced in the Bank" against its will, in order to obtain advances against bills when other sources are closed to them. The reluctance to go to the Bank for funds arises from the higher rate charged for the accommodation

than elsewhere. Again, the Bank of England will take only the cream of a bill-broker's portfolio, setting its own high standards as to the constitution of first-class paper.

*Securities.* This denotes the holdings of stocks other than Government issues, and also is understood to include the holding of commercial bills the Bank has purchased as an investment and does not hold as security for accommodation to the money market.

*Notes.* The cover for these notes is the gold held by the Issue Department, since they are included in the first part of the return, and they can virtually be regarded as gold. These notes plus the gold and silver coin constitute the Bank's own cash reserve against its banking liabilities.

**Bank Reserve.** The Bank Return's importance lies in the significance read into the published figures in regard to the proportion which the Banking Department's holding of gold bears to its liabilities by way of deposits. On the Bank Reserve all demands must ultimately fall. The proportion of reserve might easily be included in the return, but as it is, a simple calculation reveals the all-important percentage. This is obtained by totalling the Bank's liabilities in respect of Public Deposits, Other Deposits, and Seven Day Bills, which in the Return dated 19th January, 1933, amounted to £150,003,134. To offset these liabilities the Banking Department holds a cash reserve of £40,906,926, made up by the notes equivalent to gold, and the gold and silver coin. Thus the percentage in accordance with the trend of that time is the remarkably low one of 27 per cent.

Since the early months of 1933, the large increase that has taken place in the gold stocks of the Bank has caused this percentage to assume high proportions.

## **BANK OF ENGLAND AS GOVERNMENT'S AGENT**

The precise relationship that exists between the Bank and the Government of the day is surrounded with considerable mystery, and it is only in connection with the management of the note issue that definite details of operations can be noted.

There are many other directions in which the Bank carries out the plans of the Government, the chief of which are the issue of Treasury Bills and the placing of loans. The Treasury Bill procedure has already received attention, and it remains to indicate the activities of the Bank as the agent for Government issues. The outside world never fails to register surprise at the rapidity with which the Bank handles such large issues of capital. Without wishing to detract in any way from the perfect organization which has been established, it must be pointed out that circumstances favour the Bank when a comparison is made between the ordinary issues, handled by the clearing banks, and the Government issues.

In the first place, the Government issues being confined to stocks have little or no interest for the ordinary investor, unless patriotic reasons are uppermost, as in the case of War Loan. This reduces the number of applications considerably, and whereas the clearing banks for their issues are called upon to receive thousands of applications from the small investors, the Bank of England has comparatively few to handle. Again, the money market is made aware at the opportune moment of the terms of any proposed new issues of Government Stock, which ensures large blocks being applied for by the constituent members.

No consideration is given to country applications for Government issues such as is generally extended with ordinary issues. Finally, it is to be presumed that the plans for the allotment of stock in the event of an over-

subscription are more quickly passed by the Government than in the case of the directors of a public company having to make a decision.

The system of book-keeping employed by the Bank of England to record the holders of stock in Government loans differs but slightly from that employed by an ordinary public company to record the holdings of its shareholders. It must be pointed out, however, that the books of record at the Bank are State records and they are carefully preserved in the archives when they are out of date. The two most salient features of the Bank's successful handling of the enormous number of entries involved may well be reckoned the concentration of a large trained staff and the great asset of building space at the disposal of the Bank.

It is of interest to note that the Bank has acted as the Government's agent for new loans since 1715, when it superseded the Exchequer and was empowered to receive subscriptions for £910,000 5 per cent annuities. Two years later a sinking fund was established by the Government and the management of the various state loans transferred to the Bank.

## CHAPTER V

### BANK BALANCE SHEETS

BEFORE the passing of the Companies Act, 1929, the only statutory obligation imposed upon a public company in connection with balance sheets was to include a copy of its balance sheet in the annual return rendered to the Registrar of Joint Stock Companies. Certain details in connection with the nature of the liabilities, and explanatory notes as to how the valuation of fixed assets was carried out, had to be included in the balance sheet, which was carefully filed at Somerset House and was on view to the public on payment of the inevitable shilling.

Prior to 1929, a certain cynical amusement could be obtained for one's shilling if one went to Somerset House equipped with the balance sheets (?) that certain companies issued to the public. A brief comparison with those tell-tale records of the Registrar would reveal astounding differences in the amount of information divulged. By adopting the simple procedure of lumping assets together it is really extraordinary how effectively the almost complete absence of any liquidity can be concealed. The boom in company promoting in preceding years rendered imperative the reforms of the 1929 Act.

### COMPANIES ACT, 1929

The following provisions of this Act went a long way in checking the subterfuges adopted in the past, when shaky companies wished to present a better position in their balance sheets than actually was the case. Liabilities are dealt with first.

1. Section 124 stipulated that every balance sheet of a company must contain a summary of the authorized capital, and the proportion issued.

2. Section 46 referred to the issue of redeemable preference shares. This Section authorizes the issue of such shares only on the condition that a statement is incorporated on the balance sheet indicating what part of the issued capital consists of redeemable shares and the date on or before which redemption takes place.

3. In regard to liabilities, Section 124 (3) provides that where a liability is secured by any assets the fact must be so stated, but there is no duty to specify the particular assets involved.

4. Section 75 (3) enacts that where a company has power to re-issue debentures which have been redeemed, particulars with respect to the debentures which can be so re-issued shall be included in every balance sheet of the company. By a curious omission the force of this section is diminished by the fact that there is no penalty on a company's officials for disregarding the law!

5. Also, on the liabilities side, any indebtedness to a subsidiary company by loan or otherwise must be set out on the balance sheet separate from all other liabilities.

The Act deals in general terms with the details required for liabilities and assets, and indicates that sufficient data must be given in the balance sheet to reveal their general nature. It would appear that the detailed requirements of a balance sheet are better established by custom rather than by law, with the latter defining the boundaries within which variations can be allowed.

In regard to the assets, the following sections amplify what is required.

1. Section 124 requires fixed assets to be distinguished

from floating assets. No attempt is made within the Act to distinguish between these two types of assets, and most companies have so adjusted their balance sheets as to set out each particular asset separately, thus avoiding any possible contravention of the law.

2. Section 124 also provides that the basis of valuation of fixed assets must be stated. The purpose of this duty is to enable a reader of a balance sheet to study whether the estimate is based on optimistic lines or whether allowances have been made for depreciation, etc.

3. The law has been tightened up in relation to intangible assets, of which "Goodwill," "Patents," and "Preliminary Expenses" are the most common examples. If it is deemed necessary to include such items among the assets, they must be specified separately in the balance sheet. A further proviso is that the balances of any commission payable in respect of shares or debentures must appear on every balance sheet until written off.

4. Section 47 sanctions, under certain conditions, the issue of shares at a discount, provided that the amount of such discount allowed is shown, if still outstanding, as a separate item in the assets.

5. Section 125 states that where a company's assets include shares in, or debts owing by, a subsidiary company, the value of such shares, and the amount of such indebtedness must be shown separately in the balance sheets.

It is perhaps unnecessary to emphasize that the balance sheets of English banks have always been free from any suspicion, and in the same way as those of first-class public companies, the annual statement forms a reliable guide to the resources of the institution. The passing of the 1929 Act involved no great change in bank balance sheets, except in connection with the profit and loss account which has

now to be attached to every balance sheet of a public company.

If any criticism can be levelled at the banks in regard to their balance sheets, it would appear to direct itself against the policy of maintaining secret reserves. The principle of amassing large reserve funds has always been a feature of British banking, and this has been carried a step further since the post-war amalgamations. In recent years the banks have greatly strengthened the inner, or undisclosed, reserves, in order the better to meet any possible contingency. The methods adopted to create these reserves and the possible objections to the system will be indicated later.

## EXAMINATION OF BALANCE SHEETS

In order to cover the field of British and Colonial banking as widely as possible, the balance sheets of differing classes of banks are given; it will be noticed that the main features are the same, and it is only when the special characteristics of the banks in question are under review, that any notable distinction arises in their balance sheets.

It will be appropriate if we examine first the balance sheet of the largest Joint Stock Bank in this country, namely, that of the Midland Bank.

**Liabilities.** Commencing with the liabilities, we find a note at the head giving the authorized share capital, which is the amount of capital the bank could issue if required.

The actual share capital issued comes next, and this amount must be included in the total of liabilities. It will be noticed that the different classes of shares are indicated, together with the amount paid. The unpaid proportion of the £12 shares is a reserve fund as far as the bank's depositors are concerned, since if the bank failed



BALANCE SHEET OF  
31ST DECER

| <i>Liabilities</i>  |       |                |              |                    |       |
|---|-------|----------------|--------------|--------------------|-------|
|   |       | £              | s. d.        | £                  | s. d. |
| Share Capital Authorized—   |       |                |              |                    |       |
| 2,869,079 Shares of £12 each  | . . . |                |              | 34,428,948         | - -   |
| 2,000,000 Shares of £2 10s. each  | . . . |                |              | 5,000,000          | - -   |
| 5,771,052 Shares of £1 each   | . . . |                |              | 5,771,052          | - -   |
|   |       |                |              | <u>£45,200,000</u> | - -   |
| Share Capital Issued—   |       |                |              |                    |       |
| 2,869,079 Shares of £12 each, £2 10s. paid  | . . . | 7,172,697      | 10 -         |                    |       |
| 1,921,677 Shares of £2 10s. each, fully paid  | . . . | 4,804,192      | 10 -         |                    |       |
| 2,271,122 Shares of £1 each, fully paid   | . . . | 2,271,122      | - -          |                    |       |
|   |       |                |              | <u>14,248,012</u>  | - -   |
| Reserve Fund  | . . . |                |              | 11,500,000         | - -   |
| Dividend payable on 1st February, 1933  | . . . |                |              | 854,880            | 14 4  |
| Balance of Profit and Loss Account, as below  | . . . |                |              | 859,397            | 6 -   |
|   |       |                |              | <u>27,642,290</u>  | - 4   |
| Current, Deposit, and other Accounts  | . . . | 415,413,875    | 10 3         |                    |       |
| (Including £267,542 10s. on Public and other<br>Accounts secured as <i>per contra</i> )   |       |                |              |                    |       |
| Balances due to Affiliated Companies  | . . . | 3,869,090      | 3 7          |                    |       |
|   |       |                |              | <u>419,282,965</u> | 13 10 |
| Acceptances and Confirmed Credits on account of<br>Customers  | . . . |                |              | 10,669,816         | 18 5  |
| Engagements on account of Customers   | . . . |                |              | 4,942,906          | 2 9   |
| The Bank has contracts running for the sale of<br>Foreign Currencies to the value of £24,824,747<br>12s. 5d., which are covered by purchases to a<br>corresponding amount |       |                |              |                    |       |
| The total sum paid to Directors as remuneration<br>for their services is as follows—  |       |                |              |                    |       |
|   |       | £              | s. d.        |                    |       |
| Fees and Income Tax thereon<br>at 4s. 6d. in the £, paid by<br>the Bank   | . . . | 44,180         | 11 -         |                    |       |
| Fees and Income Tax thereon<br>at 4s. 6d. in the £, paid by<br>Affiliated Companies to such<br>Directors of those Com-<br>panies as were also Directors<br>of the Bank    | . . . | 5,625          | 4 10         |                    |       |
| Total   | . . . | <u>£49,805</u> | <u>18 10</u> |                    |       |

£462,357,978 15 4

## THE MIDLAND BANK

BER, 1932

| <i>Assets</i>  |            |       |                   |
|--|------------|-------|-------------------|
|  | £          | s. d. | £ s. d.           |
| Coin, Bank Notes, and Balances with the Bank of England  |            |       | 43,007,980 12 2   |
| Balances with, and Cheques in course of Collection on other Banks in Great Britain and Ireland                   |            |       | 14,348,541 13 11  |
| Money at Call and Short Notice   |            |       | 20,596,690 1 -    |
| Investments at or under Market Value—  |            |       |                   |
| War Loan and other British Government Securities (of which £397,366 5s. is lodged for Public and other Accounts) | 91,565,600 | 6 -   |                   |
| British Corporation Stocks   | 291,859    | 13 2  |                   |
| Dominion, Colonial, and Foreign Government Stocks and Bonds  | 647,710    | 19 -  |                   |
| Sundry Investments   | 560,179    | 17 6  |                   |
|  |            |       | 93,065,350 15 8   |
| Bills Discounted.  |            |       | 86,505,644 9 1    |
|  |            |       | 257,524,207 11 10 |
| Advances to Customers and other Accounts ( <i>less</i> provision for Doubtful Debts and Contingencies)           |            |       | 170,230,809 11 1  |
| Midland Bank Executor and Trustee Company Ltd.:<br>Loans on behalf of Clients                                    |            |       | 190,263 13 9      |
| Liabilities of Customers for Acceptances, Confirmed Credits and Engagements.                                     |            |       | 15,612,723 1 2    |
| Bank Premises at Head Office and Branches, at cost <i>less</i> amount written off                                |            |       | 9,626,535 3 7     |
| Other Properties and Work in Progress for extension of the business, at cost <i>less</i> amount written off      |            |       | 1,079,597 3 9     |
| Yorkshire Penny Bank Limited—  |            |       |                   |
| 93,750 Shares of £5 each, £3 paid  | 281,250    | - -   |                   |
| 93,750 Shares of £1 each, fully paid   | 93,750     | - -   |                   |
| Proportion of Reserve relative thereto   | 375,000    | - -   |                   |
|  |            |       | 750,000 - -       |
| Shares in Affiliated Companies—  |            |       |                   |
| Belfast Banking Company Limited:<br>200,000 Shares of £12 10s. each, £4 paid.                                    | 800,000    | - -   |                   |
| Reserve and Undivided Profits  | 774,885    | 15 9  |                   |
|  |            |       | 1,574,885 15 9    |
| The Clydesdale Bank Limited:<br>100,000 Shares of £50 each, £10 paid<br>30,000 Shares of £10 each, fully paid    | 1,300,000  | - -   |                   |
| Reserve and Undivided Profits  |            |       |                   |
|  | 1,692,471  | 18 -  |                   |
|  |            |       | 2,992,471 18 -    |
| North of Scotland Bank Limited:<br>163,000 Shares of £20 each, £7 paid   | 1,141,000  | - -   |                   |
| Reserve and Undivided Profits  | 1,235,393  | 8 9   |                   |
|  |            |       | 2,376,393 8 9     |
| Midland Bank Executor and Trustee Company Limited:<br>200,000 Shares of £5 each, £1 paid.                        | 200,000    | - -   |                   |
| Reserve and Undivided Profits  | 200,091    | 7 8   |                   |
|  |            |       | 400,091 7 8       |
|  |            |       | £462,357,978 15 4 |

**PROFIT AND LOSS ACCOUNT**  
**FOR THE YEAR ENDED 31ST DECEMBER, 1932**

|   | £                 | s.        | d.       |   | £                 | s.        | d.       |
|---|-------------------|-----------|----------|---|-------------------|-----------|----------|
| To Interim Dividend, paid<br>15th July, 1932, at<br>the rate of 16 per cent<br>per annum, <i>less</i> Income<br>Tax | 854,880           | 14        | 4        | By Balance from last<br>Account   | 850,015           | 18        | 10       |
| „ Dividend payable 1st<br>February, 1933, at the<br>rate of 16 per cent per<br>annum, <i>less</i> Income<br>Tax     | 854,880           | 14        | 4        | „ Net Profits for the year<br>ended 31st December,<br>1932, including the<br>sum of £370,170 divi-<br>dends from Affiliated<br>Companies, after mak-<br>ing full provision for<br>Rebate and Expenses,<br>and an appropriation<br>towards Bad and<br>Doubtful Debts (all of<br>which have been fully<br>provided for) | 2,019,142         | 15        | 10       |
| „ Reserve for Future Con-<br>tingencies   | 300,000           | -         | -        |   |                   |           |          |
| Balance carried forward<br>to next Account  | 859,397           | 6         | -        |   |                   |           |          |
|   | <u>£2,869,158</u> | <u>14</u> | <u>8</u> |   | <u>£2,869,158</u> | <u>14</u> | <u>8</u> |

or got into difficulties, the shareholders could be called upon to pay up to £9 10s. on each share they held.

“Reserve Fund” is the bank’s “open” reserve as opposed to the “hidden” reserve, and the strength of the bank is shown in the high figure at which this fund stands. Until 1931, the reserve funds of the Big Five exactly equalled their paid-up capital, but the close of that year was marked by exceptionally low prices for gilt-edged and other high-class British securities, due to readjustments after the August crisis. This low range of prices caused the banks to write down their investments from the previous valuation to a correspondingly lower level. The procedure adopted to balance the drop in assets was to reduce the reserve funds by the amount necessary to show investments on a present price basis. Needless to say, it was fully realized that British credit stood at an unjustifiable low level at that time, and the course adopted was calculated to cause the least upheaval to the balance sheets, while permitting an easy adjustment with a return to normal conditions. The year 1932 saw a marked appreciation in the bank’s investments, but there has been no attempt on the part of the banks to

re-value their holdings; presumably it is considered that international affairs are as yet in too unsettled a state to warrant a return to the previous strength of the reserve funds. In the meantime, the inner reserves benefit from the rise in prices of these investments.

"Dividend" payable at the declared rate for the previous six months and "Balance of Profit and Loss Account" are self-explanatory items.

"Current, Deposit, and other Accounts" represent the funds deposited with the bank by its customers. This item naturally stands at a high proportion of the bank's balance sheet total, since it represents a main function of a bank.

Current Accounts refer to that type of account that normally carries no interest on any credit balance, since the customer has the privilege of withdrawing funds at will. Deposit Accounts concern chiefly those funds deposited under an implied agreement that they will not be withdrawn unless notice has been previously given to the bank; interest is paid at the fixed London deposit rate in the case of town branches, but more competitive rates apply in the country. In regard to the small depositor, the difference between current and deposit accounts is largely theoretical, since no bank makes a practice of refusing requests for withdrawal of funds from the latter, merely on the grounds that due notice has not been given. In fact, cheques are usually paid on presentation when drawn on a deposit account, but this can hardly be termed a satisfactory procedure, when interest is paid for the use of the money. It is with the more affluent customers that banks must exercise their right of due notice before withdrawal of deposits. A series of large withdrawals on any one day on the part of several large depositors might seriously tax the bank's liquid resources available for that day. Other

Accounts included in this heading refer to home safe accounts and the less important items, such as dormant accounts, etc.

When the accounts are ruled off for balancing purposes, it is evident that, under the system of crediting a customer's account with all cheques paid in without delaying to ascertain whether they are paid, there must be included in the balance sheet under the heading of current accounts certain sums which represent uncleared effects. A glance at the assets side of the balance sheet, however, will reveal that this is counteracted by the item "cheques in Course of Collection, etc."

"Balances due to Affiliated Companies" represents a state of account as between the principal bank and its off-shoots, and may have arisen from the variety of banking operations that the former would normally undertake for the latter, or it may represent funds lodged by the affiliated companies for better employment by the parent bank.

"Acceptances and Confirmed Credits on account of Customers" needs but little explanation here, since the principle of bank credits has already been stated. It will be recalled that, in effect, the bank lends its name to customers on bills of exchange, the customer being under the obligation of putting the bank in funds to meet the bill before maturity. For this contingent liability the bank must make provision in the balance sheet. Thus, on the liabilities side will figure the bank's liability on its acceptances, while on the assets side will be found the same figure for the customer's liability to the bank, only here it will be found amalgamated with another item termed "Engagements."

"Engagements on Account of Customers" covers the practice of a bank issuing an indemnity on behalf of its

customers. These indemnities are chiefly issued in respect of lost registered share certificates, allotment letters, and coupons. They are sometimes drawn up to cover any deficiency in the documents presented to another bank for its acceptance under a credit established for that purpose. In all cases, the banks obtain a counter-indemnity from the customer, undertaking to recompense them for any demand for satisfaction under their guarantees. For this reason, the amount of these engagements figures on both sides of the balance sheet.

For information purposes only, mention is made of the amount of foreign currency sales the bank have running at the date of the balance. It is one of the canons of sound banking that in dealing in foreign currencies every purchase must be covered by a sale and *vice versa*. In this way the speculative element is excluded and the various deals negotiated for customers are self-balancing from the bank's point of view, except for the commission charged, which goes to swell the total profits of the bank.

In a praiseworthy attempt to put a stop to what was becoming an alarming practice, the promoters of the Companies Act, 1929, inserted a clause making it necessary for the balance sheets of public companies to contain a record of the amount of remuneration the directors received for their services. It is extremely doubtful whether this provision has stopped the activities of the directors of certain companies who are engaged in the profitable occupation of lining their own pockets at the expense of unfortunate shareholders. On the other hand, it appears that many company directors must work at a ridiculously low remuneration; whether from altruistic motives towards the shareholders, or a sense of their own value must be left to conjecture. In the case of

well managed and ably directed institutions like banks, it seems unnecessary that they should be called upon to state the director's salaries, but the law dictates.

**Assets.** Turning to the assets appearing in the balance sheet, we see at once that the more liquid assets appear at the head of the list. Thus, the cash reserve, which is held in the greatest degree of liquidity, figures foremost. "Coin and Bank Notes" constitute the bank's till money, while the balance with the Bank of England, as already explained in the previous chapter, is held to meet all withdrawals through the Clearing House and other channels.

"Money at Call and Short Notice" will be familiar to readers by this time, consisting as it does of the funds loaned to the money market under conditions of short notice of its recall.

"Investments" need no particular explanation beyond drawing attention again to the basis of valuation which applies with particular emphasis at the present time. The proportion of funds allocated to the various classes of securities makes interesting reading and provides an illustration of the bank's avoidance of speculative enterprise, a policy which is common to all the big banks.

"Bills Discounted" figure at an abnormally high sum for the year under review, due to the special economic causes functioning. Other banks make a practice of revealing in their balance sheets under the heading of Bills Discounted, the proportion between Treasury Bills, bills on British companies and institutions, and other bills. It is safe to assume that the Midland Bank's proportion of Treasury bills to bills of other description is about 85 per cent. Again, the security of the assets is beyond question, and although it is not the practice of banks to re-discount their bills bought for investment, should any abnormal circumstances arise, there exists

the medium of the London Discount Market to utilize for their operations.

The assets outlined above all fall in the category of definite liquid assets, and as such are totalled to the formidable figure which represents over 60 per cent of the total amount of deposits.

"Advances to Customers" are at a low figure in the 1932 balance sheet owing to the contraction in all forms of industrial activity. It has become a common event to read in bank reports that money has been practically unusable at times, although it must be pointed out that the banks could easily place funds into sundry enterprises of a speculative nature, but the principles of prudent banking would be violated in the process. The subject of advances to customers is one which calls for special treatment, which would be out of place here, but a few words may be added in connection with the statement which appears in the balance sheet "less provision for Doubtful Debts and Contingencies."

It is the practice for all the British banks to draw up their balance sheets after making provision for bad and doubtful debts. The gradual deterioration of a loan from a good asset to a doubtful debt may be coincident with the operation of an undertaking on a profit paying basis until it lapses into insolvency. The process may be further stated as from the interest yielding period of a loan, apparently well secured, to the period when the interest is paid, but the future principal repayment is uncertain, until finally there exists but small prospect of obtaining either interest or principal. Here, of course, the value of the security is an all-important factor, but in many cases this declines consequent upon the undertaking ceasing to be a going concern. Although no indication is given as to the extent of the provision made



by the banks, it can be taken for granted that it is ample. The augmenting of inner reserves can be carried out by means of this provision, since by adopting an over-cautious attitude towards debts which are scarcely of the doubtful variety, the assets side of the balance sheet can be reduced below the highest possible estimate.

"Bank Premises" form a valuable asset and consistently figure at a conservative value in the balance sheets of the Big Five banks. With this item it is possible to make the most obvious additions to secret reserves, although the actual amounts may not be comparable to the more subtle appropriations. The words "at cost less amount written off" cover a wide field, and the actual amount stated in the balance sheet under this heading is almost nominal.

The remainder of the balance sheet deals with the bank's holdings in its subsidiary and affiliated companies. These details are given in accordance with the Companies Act, 1929.

**Profit and Loss Account.** In order to conform to the regulations laid down by the Companies Act, 1929, a profit and loss account is attached to the balance sheet, stating the amount brought in from the last account and the net profits for the period under review. In the debtor side it is necessary to include the amounts absorbed by interim and final dividends, the appropriations to reserve (the law is silent about secret reserves), and the balance carried forward to the next account.

For the second example of a bank balance sheet the choice has fallen on that of the Bank of London and South America. This institution may be taken as representative of the group of banks outside the inner group of the larger domestic banks. The members of this outer ring are mainly concerned in financing colonial

and foreign trade between this country and the particular area to which they mainly confine their operations. In connection with this balance sheet, it will be observed that the main characteristics are similar to those of the Midland Bank, although the figures are naturally considerably lower.

BALANCE SHEET OF THE BANK OF LONDON  
AND SOUTH AMERICA

30TH SEPTEMBER, 1932

*In countries where exchange restrictions are in force, conversions  
have been made at the official rates ruling on 30th September, 1932*

| <i>Liabilities</i>  | <i>£</i>           | <i>s.</i> | <i>d.</i> |
|---|--------------------|-----------|-----------|
| Share Capital—  |                    |           |           |
| Authorized, 800,000 Shares of £5 each, £4,000,000 ;         |                    |           |           |
| Issued, 708,000 Shares of £5 each, fully paid . . . . .     | 3,540,000          | —         | —         |
| Reserve . . . . .   | 1,500,000          | —         | —         |
| Current and Deposit Accounts, etc., and Contingency Reserve | 41,368,196         | 13        | 9         |
| Deposit by Brazilian Trust and Loan Corpn., Ltd.            | 68,985             | 16        | 8         |
| Bills Payable . . . . .                                     | 629,962            | 4         | 9         |
| Acceptances on Account of Customers . . . . .               | 1,152,746          | 12        | 3         |
| Bills for Collection on Account of Customers . . . . .      | 7,823,294          | 7         | 6         |
| Rebate of Interest on Bills not due . . . . .               | 141,055            | 9         | 3         |
| Profit and Loss Account . . . . .                           | 498,451            | —         | 8         |
|   | <u>£56,722,692</u> | <u>4</u>  | <u>10</u> |

*Note.* Contingent liability as endorsers of foreign bills discounted £746,737, of which £661,875 has since run off.

| <i>Assets</i>   | <i>£</i>           | <i>s.</i> | <i>d.</i> |
|---|--------------------|-----------|-----------|
| Cash in hand, at Bankers, and at Call . . . . .   | 17,069,413         | 14        | 10        |
| Bills Receivable . . . . .  | 10,354,867         | 18        | 8         |
| Advances and other Accounts Receivable, Securities, etc., after making provision for all Bad and Doubtful Debts . . . . . | 18,304,984         | 8         | —         |
| Investment in Brazilian Trust and Loan Corpn., Ltd.   | 36,796             | 12        | —         |
| Liability of Customers for Acceptance, <i>per contra</i> . . . . .  | 1,152,746          | 12        | 3         |
| Bills for Collection, <i>per contra</i> . . . . .   | 7,823,294          | 7         | 6         |
| Bank Premises and Furniture, at cost, <i>less</i> amounts written off . . . . .   | 1,980,588          | 11        | 7         |
|   | <u>£56,722,692</u> | <u>4</u>  | <u>10</u> |

In accordance with Section 126 of the Companies Act, 1929, we hereby state that the profit of the Brazilian Trust and Loan Corporation, Ltd. (the whole share capital of which is held by the Bank) for the year ended 30th June, 1932, has not been taken credit for in the Bank's accounts.

A brief analysis of this statement will reveal that the normal banking practice is followed in preserving a high proportion of liquid assets, a practice which curtails to a certain extent the earning powers of the funds in possession of the bank. The most notable feature of the balance sheet is the prominence of bills of exchange, which is not surprising when the essential function of the bank is the promoting of trade between this country and South America. The bill of exchange, as already explained, is the medium through which international indebtedness is settled.

On the liabilities side, "Bills Payable" represent British exports into South America which the bank assisted to finance. In the same way "Bills Receivable" on the assets side represent imports into this country. By negotiating bills drawn under credits issued by other banks the Bank of London and South America can advance to its customers in South America funds to expand their export trade and to develop their production. Since the bank exists chiefly to finance international trade the security it holds against advances, loans, and bills negotiated will consist of documents of title to goods in a greater proportion than any other type of banking security.

"Bills for Collection" do not necessarily affect the bank's resources owing to the contingent liability of the customer's, but should a customer fail to re-imburse the bank a contingency reserve is available for any deficits.

For the third type of balance sheet to be investigated it has been thought that greater interest would be aroused if an example of dominion banking be appended. Canadian banking has been chosen, partly on account of its highly developed banking system, and partly because of the

fact that traces of American influence can be observed. A useful and interesting feature of Canadian banking is the publication by the Government every month of a detailed statement of the position of each bank, the banks being compelled by the Bank Act to furnish the Government with monthly returns. The details the banks are under obligation to include in their statements are shown below, but as the figures change month by month, the percentage to public liabilities is given instead of the customary amounts. These percentages were worked out by a distinguished Canadian banker,<sup>1</sup> based on the annual balance sheets of a number of banks for the three years 1929, 1930, and 1931.

It is perhaps unnecessary to add that the liability of a bank to the public is particularly important, revealing as it does the strength of the resources, liquid or otherwise, to contend with any loss of confidence on the part of the depositors. It will be seen that the Canadian banks are compelled by the Government to yield far more information about their operations than the banks of this country; particularly does this apply in regard to the proportion of assets held in Canada compared with those held elsewhere.

The greater part of the foregoing statement requires little amplifying, but in order to conclude completely the review of bank balance sheets, brief mention may be permitted of the items peculiar to Canadian banks.

**Liabilities.** In regard to the circulation of notes the banks can issue notes without any special legal reserve requirements to the amount of their paid-up capitals; any notes issued in excess of these figures having to be secured, dollar for dollar, by a deposit in the Central Gold Reserves.

<sup>1</sup> *Canadian Banking*, by E. L. Stewart Patterson.

# RETURN OF THE LIABILITIES AND FROM THE MONTHLY

## *Liabilities*

|  | Percentage<br>to Public<br>Liabilities |
|--|--|
| 1. Notes in circulation . . . . .  | 5·18                                   |
| 2. Balance due to Dominion Government after deducting<br>advances for credits, pay-lists, etc. . . . .   | 4·03                                   |
| 3. Advances under the Finance Act . . . . .  | 2·34                                   |
| 4. Balances due to Provincial Governments . . . . .  | ·64                                    |
| 5. Deposits by the public, payable on demand in Canada .   | 21·93                                  |
| 6. Deposits by the public, payable after notice or on a<br>fixed day, in Canada . . . . .                | 49·63                                  |
| 7. Deposits elsewhere than in Canada . . . . .   | 11·39                                  |
| 8. Loans from other banks in Canada, secured, including<br>bills re-discounted . . . . .                 |  |
| 9. Deposits made by and balances due to other banks in<br>Canada . . . . .                               | ·37                                    |
| 10. Due to banks and banking correspondents in the<br>United Kingdom . . . . .                           | ·20                                    |
| 11. Due to banks and banking correspondents elsewhere<br>than in Canada and the United Kingdom . . . . . | 1·96                                   |
| 12. Bills Payable . . . . .  | ·13                                    |
| 13. Letters of credit outstanding . . . . .  | 2·09                                   |
| 14. Liabilities not included under foregoing heads . . . .   | ·11                                    |
| Total liability to public . . . . .  | 100·00                                 |
| 15. Dividend unpaid<br>Undivided and accumulated profit  | } 11·38                                |
| 16. Rest or Reserve Fund   |  |
| 17. Capital paid up  |  |
|  | 111·38                                 |

**ASSETS OF THE CANADIAN BANKS**  
**GOVERNMENT STATEMENT**

*Assets*

|   | Percentage<br>to Public<br>Liabilities |
|---|--|
| 1. Current gold and subsidiary coin . . . . .   | 3·11                                   |
| 2. Dominion notes . . . . .   | 5·46                                   |
| 3. Notes of other banks . . . . .   | ·52                                    |
| 4. United States and other foreign currencies . . . . .   | ·68                                    |
| 5. Cheques on other banks . . . . .   | 4·06                                   |
| 6. Loans to other banks in Canada, secured, including<br>bills re-discounted . . . . .  |  |
| 7. Deposits made with and balances due from other<br>banks in Canada . . . . .  | ·11                                    |
| 8. Due from banks and banking correspondents in the<br>United Kingdom . . . . .   | ·16                                    |
| 9. Due from banks and banking correspondents else-<br>where than in Canada and the United Kingdom . . . . .   | 3·20                                   |
| 10. Dominion Government and Provincial Government<br>securities . . . . .   | 18·06                                  |
| 11. Canadian municipal securities, and British, foreign,<br>and colonial public securities, other than Canadian . . . . .   | 5·52                                   |
| 12. Railway and other bonds, debentures, and stocks . . . . .   | 2·01                                   |
| 13. Call and short (not exceeding thirty days) loans in<br>Canada on stocks, debentures, bonds, and other<br>securities of a sufficient marketable value to cover . . . . . | 5·58                                   |
| 14. Call and short (not exceeding thirty days) loans else-<br>where than in Canada on stocks, etc. . . . .  | 4·02                                   |
| 15. Other current loans and discounts in Canada . . . . .   | 39·19                                  |
| 16. Other current loans and discounts elsewhere than in<br>Canada after making full provision for bad and<br>doubtful debts . . . . .                                       | 6·53                                   |
| 17. Loans to the Government of Canada . . . . .   | 1·49                                   |
| 18. Loans to provincial Governments . . . . .   |  |
| 19. Loans to cities, towns, municipalities, and school<br>districts . . . . .   | 4·19                                   |
| 20. Non-current loans, estimated loss provided for . . . . .  | ·38                                    |
| 21. Real estate, other than bank premises . . . . .   | ·23                                    |
| 22. Mortgages on real estate sold by the bank . . . . .   | ·22                                    |
| 23. Bank premises, at not more than cost, less amounts<br>written off . . . . .   | 2·84                                   |
| 24. Liabilities of customers under letter of credit as <i>per</i><br><i>contra</i> . . . . .  | 2·09                                   |
| 25. Deposit with the Minister of Finance for the security<br>of note circulation . . . . .  | ·24                                    |
| 26. Deposit in the central gold reserves . . . . .  | ·91                                    |
| 27. Shares of and loans to controlled companies . . . . .   | ·52                                    |
| 28. Other assets not included under the foregoing heads . . . . .   | ·06                                    |
|   | <b>111·38</b>                          |

Dominion and Provincial Government balances represent the money deposited by the various provinces, and, after notes, form a first lien on the assets of a bank that fails.

Advances under the Finance Act concern the amounts borrowed by the banks from the Dominion Government against specified securities. These advances are for special requirements such as the overlapping of seasonal loans and maintaining the reserve for the note issues.

**Assets.** The only important divergence from English banking practice in the distribution of the assets concerns the employment of Call Loans elsewhere than in Canada.

These call loans are carried in London and New York, the reason being, not as has been suggested, the making of greater profit in these centres, but to serve their depositors interests by having available balances withdrawable on demand in times of stress and to provide for debts or exchange transactions on these centres.

One last explanation concerning an item of minor importance, which, however, is not devoid of interest. We refer to the heading "Real Estate." Banks are not allowed to hold real estate other than that required for their own premises, nor can they lend on mortgages. They can, nevertheless, take a mortgage as additional security for a debt already incurred, and in the event of foreclosure they are allowed to bid in the property. By the Bank Act such property must be disposed of within seven years. In this manner do the banks sometimes endeavour to improve a bad or doubtful debt.

## CHAPTER VI

### THE CONDUCTING OF CURRENT ACCOUNTS

THE diverse duties a bank undertakes for its customers entail the employment of a vast number of books in which to record the entries consequent upon the customers taking advantage of the facilities provided. Any description of these books must for this reason be somewhat lengthy, or otherwise be labelled incomplete. At the risk of incurring the stigma of the alternative, we propose to attempt the restriction of the entries dealt with in this chapter to those of an importance sufficient to leave the reader with something more than a shadow to chase.

The relation subsisting between banker and customer is that of debtor and creditor. That these positions are interchangeable is common knowledge and may be set aside for the present. Since the consideration giving rise to the debt is purely monetary, it follows that a bank must keep an accurate recording of the amounts involved, particularly because it may be called upon to repay the debt at any time on demand. Further preamble is unnecessary to introduce the ledger, towards which all banking operations gravitate. Every customer of a bank is given a page in the ledger and the state of account between him and the bank is kept up to date. In this chapter we are concerned only with those customers of a bank who maintain a current account. Their names will form the headings of the current account ledgers. On the other hand, the customers who lend money to a bank on deposit account will have their accounts set forth in the deposit ledgers.



The cheque has become such a familiar document that its scope and form call for no explanation. A customer, having opened an account with a bank, is provided with a cheque book on request, and a supply of forms enabling him to place funds to his credit.

### PAYMENTS TO CREDIT

When a customer hands cheques, bank notes, etc., to his bank for the credit of his account, a preliminary entry is made by the cashier in his journal, of which the following is an example—

RECEIVED CASH BOOK

| Cash<br>Given<br>Out |    |    | Name         |   |  | Total |    |    | Bank<br>Notes       | Country<br>Notes | Cash |    |    |
|----------------------|----|----|--------------|---|--|-------|----|----|---------------------|------------------|------|----|----|
| £                    | s. | d. |              |   |  | £     | s. | d. |                     |                  | £    | s. | d. |
|                      |    |    | Brown & Co.  | . |  | 76    | 10 | —  | £50<br>No.<br>12345 |                  |      |    |    |
|                      |    |    | A. Jones .   | . |  | 4     | 6  | 2  |                     |                  |      | 2  | 2  |
|                      |    |    | Morton Bros. | . |  | 924   | 8  | 3  |                     |                  |      |    |    |

The cashier makes his entries from the slip that accompanies all articles paid in for the credit of customers. It will be at once seen that cheques are not stated separately in the cash book, but the bank notes of £5 and upwards, country notes, and cash (including bank notes of £1 and 10s.) are entered in different columns. Thus, Brown and Co. paid in a total credit of £76 10s., comprising one bank note for £50 and the remainder in cheques. Jones, on the other hand, paid in cheques to the amount of £4 4s. and 2s. 2d. in cash, totalling £4 6s. 2d. The last example, Morton Bros., paid in a credit made up entirely of cheques.

The first column of the cash book is not generally met

with, but has been included in this example so that mention may be made of the infrequent transactions where a bank gives cash for an article not drawn upon itself. Postal orders may be cited as the chief exchanges a bank effects, and sometimes cash is given for a cheque drawn on another bank. These transactions are fraught with considerable risk, however, since by giving cash the bank becomes a holder for value, and as such, cannot claim to be within the protection afforded to collecting banks in the event of a customer having no title or a defective title to the article in question.

Country notes refer to the notes issued by Scotch and Irish banks; there are no country bank notes issued in England nowadays.

The cashier agrees the amount of bank notes and cash with the paying-in slip and places the coin and notes in his till. The amount held by each cashier in his till at the end of the day is ascertained and agreed, and the bank notes of higher denominations are listed prior to being lodged with the Bank of England for the credit of the bank's account. The cashier's department is responsible for the handling of a bank's till money, particular care having to be taken to ensure an adequate supply of notes and coin to meet the demands of customers tendering cheques for payment at the counter.

The other articles, together with the paying-in slip, are passed by the cashier to the waste clerk, who is required to enter more extensive details in a day book, or waste book, as it is termed. To the waste clerk falls the duty of entering the cheques according to their various classifications. The total of the credit is entered from the slip, as also the amount of bank notes, coin, etc.; the cheques are then listed in their respective columns and the total of each credit balanced. The credit having

been agreed, the cheques are passed forward for presentation by the clearing departments, the clerk first impressing a folio number on the back of each cheque to facilitate easy reference in the event of an item charged in error to a department.

The waste clerk passes the paying-in slip to another clerk, whose task it is to sort them in alphabetical or ledger order. The amount of each credit is then listed on special credit sheets, which are agreed with the waste book summation at the end of each day. The slips are now ready for posting in the ledger and they are duly handed to the ledger clerk for that purpose. Before dealing with the entries in the ledger, we must add a few words about the final balancing of the waste book for the day.

In the first place, when the waste book is ruled off, the totals of the various columns should agree with the amount of the credits. The waste book total is first balanced with the received cash book, the bank notes and cash in the till being agreed separately with the waste book columns devoted to their record. In a large banking office it becomes necessary to employ several waste clerks, particularly towards the close of business. For this reason, waste books are invariably based on a loose-leaf system, enabling the whole of the work for any one day to be kept together. When more than one waste sheet is used a waste book summation is rendered necessary, and this book is ruled in exactly similar manner to an ordinary sheet. Needless to say, the final total of the waste summation book must agree with the separate columns, and when balanced represents the amount the bank is debtor to its customers for the day.

It has been stated that the bank notes and cash in the till are balanced with the amount as stated in the

# SPECIMEN WASTE BOOK

| Name          | Total              | Town<br>Clearing | Wells              | Bank<br>Notes | Country<br>Notes | Cash          | Country<br>Clearing  | Metropolitan<br>Clearing | Postal<br>Orders | Country<br>Agents    | Particulars |
|---------------|--------------------|------------------|--------------------|---------------|------------------|---------------|----------------------|--------------------------|------------------|----------------------|-------------|
| Brown & Co.   | £ s. d.<br>76 10 - | L. 6 10 -        | £ s. d.<br>50      | £ s. d.<br>50 | £ s. d.<br>50    | £ s. d.<br>50 | Bc.<br>York 10 10 -  | Lc.<br>Holborn 9 10 -    | £ s. d.<br>50    | £ s. d.<br>50        |             |
| A. Jones      | £ s. d.<br>4 6 2   |                  | Pay<br>Genl. 4 4 - |               |                  | 2 2           |                      |                          |                  |                      |             |
| Morton Bros.  | £ s. d.<br>924 8 3 | N.P. 4 - -       | Bk. 900 - -        |               |                  |               | M.<br>Bristol 20 8 3 |                          |                  |                      |             |
| Leslies, Ltd. | £ s. d.<br>67 3 8  |                  |                    |               |                  |               |                      |                          | 15 8             | Roy.<br>Scot. 66 8 - |             |

The abbreviations denote the banks on whom the cheques are drawn. When a customer pays in a batch of cheques containing several articles for each clearing, the individual amounts are entered in the "particulars" column with an indication of the banks upon which they are drawn. The total for each variety of cheque is then carried to the corresponding column in the book.

The first three entries correspond to those outlined in the received cash book.

waste sheet. It remains to add that eventually every column in the waste sheet is balanced, since each department agrees the amount debited to it in the waste summation book. Town clearing department, for example, will receive during the course of any given day, a number of town clearing articles from the various waste clerks. These articles are sorted into banks on which they are drawn, listed by machines, and the machined totals summarized into a total for the day, which should agree with the total of the town clearing column in the waste summation. A similar operation is performed by the other departments concerned in the waste book.

To return to the paying-in slip, which had reached the ledger clerk, the amount of the credit is posted in the appropriate folio to the credit of the customer. At first sight it may seem curious that a customer receives credit for articles that have not been collected by the bank, but it must be remembered that only in special circumstances can these effects be drawn against. There is no risk of losing protection of Section 82 of the Bills of Exchange Act provided the customer does not draw against uncleared articles, since the Bills of Exchange (Crossed Cheques) Act, 1906, extends such protection notwithstanding that the bank credits the customer's account. When a customer wishes to draw upon these uncleared cheques, it is customary to take powers to ensure that the bank shall have the right to recover any possible loss that may arise through this procedure.

The ledger entries require no elaboration since they correspond to the personal accounts kept by a trading firm. The example on page 61 shows the account headed with the name of the customer, with a space for any special instructions in regard to overdraft limits or the rate of interest charged.

# CURRENT ACCOUNT LEDGER

CHARLES MACDONALD

*Allow Interest 1% below Bank, and credit monthly*

| Date    | Particulars         | Debit | Credit  | Dr.<br>or<br>Cr. | Balance  | Days | Rate | Interest<br>Charged | Interest<br>Allowed | Interest<br>Checked<br>by |
|---------|---------------------|-------|---------|------------------|----------|------|------|---------------------|---------------------|---------------------------|
| 19..    |                     |       |         |                  |          |      |      |                     |                     |                           |
| Dec. 31 | By Balance .        | £     | s. d.   | Cr.              | £ s. d.  | 6    |      | £                   | s. d.               |                           |
| Jan. 6  | " Self .            | 5     | —       | Cr.              | 29 8 6   | 10   |      |                     |                     |                           |
| 16      | " Chq. Morris .     | 6     | —       | Cr.              | 24 8 6   | 3    |      |                     |                     |                           |
| 19      | " Cash .            |       | 3 8 4   | Cr.              | 18 2 6   | 6    |      |                     |                     |                           |
| 25      | " Lond. & N.E. Rly. | 7     | 2 1     | Cr.              | 21 10 10 | 3    |      |                     |                     |                           |
| 28      | " Chq. Book .       | 4     | 2       | Cr.              | 14 8 9   | 3    |      |                     |                     |                           |
|         | " Salary .          |       | 25 10 3 | Cr.              | 14 4 7   | 3    | 2    |                     | 7 4                 |                           |
| Feb. 1  | " Interest .        |       | 7 4     | Cr.              | 39 14 10 | 3    |      |                     |                     |                           |
|         |                     |       |         |                  | 40 2 2   |      |      |                     |                     |                           |

Each account in the ledger is ruled off every half-year and the balance, either debit or credit, carried forward to the next period. Interest entries on credit balances are generally passed half-yearly, unless special instructions vary the procedure. On the other hand, it is the practice to debit interest on overdrafts monthly, with the aforementioned proviso.

### WITHDRAWALS

Having dwelt at some length on the entries involved over payments in, we must now deal with payments out, or withdrawals by the customer. In order to obtain repayment of money lent to a bank a cheque must be drawn. This cheque can either be presented at the counter of the bank on which it is drawn, when it is styled an "open" cheque, or it may be presented by another bank through the clearing, when it is called a "crossed" cheque.

#### PAID CASH BOOK

| Total |    |    | Name              | Bank<br>Notes | Cash |    |    | Bank of<br>England<br>Transfers |   |    |    |
|-------|----|----|-------------------|---------------|------|----|----|---------------------------------|---|----|----|
| £     | s. | d. |                   |               | £    | £  | s. | d.                              | £ | s. | d. |
| 10    | —  | —  | H. Brown . . . .  | 24689         | 10   | £  | —  | —                               |   |    |    |
| 32    | 8  | 1  | Jones Bros. . . . | 46285         | 5    | 27 | 8  | 1                               |   |    |    |

Taking the former method of presentation first, the cheque will be presented to a cashier, who pays it, if in order and a balance is available for that purpose on the customer's account. The payment is then recorded in the cashier's journal, ruled as shown above.

The Bank of England transfers column is used to record all cheques issued on the bank's account at the Bank of England.

When the cashier has entered the cheque he passes it to a clerk for listing on the paid cash sheets, the only details here recorded being the name of the account and the amount of the cheque. As a preliminary to this second entering of the paid cheques, they are first sorted into groups to correspond with the indexing of the ledgers, each group being entered on a separate sheet. The ledger keeper is now handed the cheque for the debit to be placed on the account in the ledger. It is important to note that, whereas with payments to credit ledger entries are made from the slips, in the case of withdrawals the ledger keeper makes his entries from the actual articles.

The great majority of cheques presented for payment to a bank arrive through the medium of the clearing house. The "runners" bring back parcels of cheques from the clearing house at certain intervals, and the articles are immediately sorted into ledger order, so that the ledger keepers can examine and post them with minimum delay. The method of settling clearing house balances will be explained later, but it can be anticipated to the extent of pointing out the need that exists for the paying bank to keep a record of all cheques presented in this manner. In a similar way as the cheques paid over the counter are listed on paid sheets, so the cheques presented through the clearing house are recorded on town sheets (so called to distinguish them from the other class of paid sheets). It follows that the totals of the town sheets plus the totals of the paid sheets will represent the amount a bank is creditor to its customers for any particular day.

From this outline of the system of entries adopted by a bank to cope with the great number of cheques presented daily for payment, it will perhaps have been noticed that the paid sheets are written up before the



ledger entries are made, whereas the town sheets are not listed until afterwards. This arrangement is one of convenience and due to the fact that cheques presented through the clearing house arrive much later than the business hours of a bank.

Now that the book-keeping entries for both payments to credit and withdrawals have been explained, it is possible to show how the ledgers are balanced weekly. First, the paid sheets and town sheets entries are called over with those in the ledger every morning, so that an error in entering can be found at once. By this method the weekly balance of a ledger is rendered less difficult. In order to balance a ledger for any given week, it only remains to take the previous week's figure, add to it the totals of the credit sheets for the current week, and subtract the totals of the paid and town sheets. Expressing the operation in general terms, the balance between the payments to credit for the week and the withdrawals for the same period must be either added to, or subtracted from, the previous week's figure.

## PASS BOOKS

The word "pass book" is tending to become obsolete in banking circles at the present time, owing to the advance of mechanization. So far in this chapter we have adhered to the old method of entering by hand in explaining the principle of current account entries, but it is important that the changes brought about by the extensive use of machines be noted. It would be out of place in this book to describe in detail the working of the various types of ledger machines. Such information can be obtained elsewhere, but it is necessary to investigate the changes wrought in the bank book-keeping system of this country by the innovation.

In the first place, the adoption of ledger machines involved a loose-leaf system of books, including the pass book. Secondly, under the old system, as explained in this chapter, the articles for posting were handled first by the ledger clerks, and then were handed to the day book clerks. By calling over the amounts from the day books to the ledger, a check was obtained on the entries posted. In regard to the pass books, the method was to write the debits up from the vouchers and the credits from the ledger, or alternatively to write up the pass book entirely from the ledger, agreeing the balance in each case with that shown in the ledger. It was further shown how the ledgers were balanced weekly, with the disadvantage of having to check back a mass of entries should a difference arise.

With the new system of mechanization<sup>1</sup> all cheques are listed first by the day book clerks, after they have been sorted into ledger order. It is customary to list the cheques in batches to facilitate balancing. After they have been recorded on the day book sheets the cheques are handed to the ledger machine operator for posting. The ledger machine, apart from its ordinary functions, records on a long sheet all items posted, and at the end will be found the total of debits and credits that have passed through the machine. The totals of the day book sheets are agreed with the totals of the ledger machine, and this process is repeated with every batch. Needless to say, the total of one batch is carried forward to the next, so that at the end of the day the final totals of debits and credits are easily agreed.

It is necessary to follow the system of mechanization a

<sup>1</sup> For a full and lucid description of the subject of mechanization, the reader is referred to an article in the *Incorporated Accountant's Journal* by C. R. Robson, Cert.A.I.B., called "Mechanization in English Banks."

stage further in order to examine the method of composing the customers' statements. To prepare for this operation the ledger clerk "offsets" each ledger account that has been active during the day. This merely consists of replacing the sheet a little in advance of the remainder after posting the entries thereon. The balances of these active accounts are machined, in the case of a debit balance the letters "O.D." following the amount. At the end of this machined list will appear one total of debit and credit balances added together. The statements are now posted from the cheques, and the balances obtained are checked with the balances of the machined list of active accounts. When the statements have been completed the machine is cleared, but a list will have recorded the total of debits posted, and of credits, and lastly a figure will be shown representing the sum total of all the new balances. This, of course, should agree with the total of the ledger balances, while the individual totals of debits and credits must be agreed with the day book totals.

The ledger machine is confined in its application to posting the ledgers and compiling statements. For the purposes of machining the day book entries, waste and remittance entries, and ordinary listing, a machine called the Shuttle Duplex is employed. This machine is commonly described as "two adding machines in one," since it has two separate registers, debit and credit.

Every departure from precedent brings difficulties in its train, and mechanization is no exception. When the printed statement was first introduced into this country, an attempt was made to standardize the description of customer's cheques paid by referring to the numbers of these articles. It was urged on behalf of this system that it was much better for the customer to have a legibly printed number on a statement that was his own property,

than to supply him with a pass book written up by hand and containing illegible abbreviations of the payee's name of each cheque. Unfortunately, the success of this system depends on an extensive use of the counterfoils by customers when drawing cheques, in order that a comparison of the cheque numbers shall bring forth the necessary information. Some banks, therefore, favour the machining of the payee's names in the ledger and statement records, under which system the maximum service is provided for the customer.

### **GENERAL CASH BOOK**

The recording of individual transactions on current accounts had been illustrated and it is proposed at this point to deal with their classification for general ledger purposes. A comprehensive summary is given in order to give some idea of the grouping of entries that takes place; the items relating to operations other than those affecting current accounts will be explained in succeeding chapters.

The general cash book, despite its name, is really a combined cash book and journal, and the entries appearing therein are posted to the general ledger. At the end of each day, the totals of the various transactions are entered on appropriate sides, in the general cash book, although frequently the practice is to set out the totals on a daily balance loose sheet, in order to avoid the alterations in the cash book that are due to adjustments in the clearing figures.

The specimen summary of a bank's transactions that is given on page 69 would be applicable to the city office of a clearing bank. The city office is the description given to that part of head office that is concerned with the banking operations, as distinct from administrative functions. For

this reason, the city office passes its entries in a similar manner to an ordinary branch, but special transactions appear owing to the work undertaken on behalf of branches.

The formidable summary of accounts in the general cash book requires a certain amount of explanation, but before proceeding to this, it may be helpful if the general ledger is introduced. It has been stated that the entries in the cash book are posted to the general ledger, but it must be remembered that the cash book is a record of transactions between the city office (or a branch) and its customer; whereas the general ledger is a status of account between the city office (or a branch) and head office.

### GENERAL LEDGER

Every branch of a bank keeps a general ledger, including the city office. In addition, head office records, in a separate ledger, the combined assets and liabilities of the whole bank, the figures being supplied on periodical returns from the branches. The general ledger is a self-balancing book, the totals of the debit and credit columns of its trial balance exactly agreeing. In this chapter, the work under discussion is applicable to the city office. Some of the adjusting items hereinafter explained will readily be recognized as applying only to that particular office.

It is now necessary to state that all entries appearing in the specimen cash book page will be entered on the reverse side in the general ledger. This requires amplification. Taking the obvious case of current accounts, the withdrawals will be entered on the credit side of the general cash book, since the city office is creditor by that amount in relation to its customers. For general ledger purposes, however, it will be clear that the city office is debtor to head office by that amount, since its resources

| Dr.     |     |    |    | GENERAL CASH BOOK   |         |     |    | Cr. |  |   |   |    |    |
|---------|-----|----|----|---|---------|-----|----|-----|--|---|---|----|----|
| £       | £   | s. | d. |   | £       | £   | s. | d.  |  | £ | £ | s. | d. |
| 9,463   | 247 | 6  | 1  | Head Office . . . . .   | 8,249   | 608 | 10 | 7   |  |   |   |    |    |
|         | 706 | 5  | —  | Country Agents . . . . .                                      |         |     |    |     |  |   |   |    |    |
| 207     | 105 | 16 | 5  | Country Cheques . . . . .                                     | 592     | 334 | —  | 5   |  |   |   |    |    |
| 27      | 577 | 3  | 6  | Bills Discounted . . . . .                                    | 77      | 486 | 1  | —   |  |   |   |    |    |
| 1,655   | 012 | 5  | 1  | Bills Discounted: "Brokers" .                                 | 410     | 000 | —  | —   |  |   |   |    |    |
|         | 78  | —  | 3  | Bills Discounted: "Foreign" .                                 |         |     |    |     |  |   |   |    |    |
| 37      | 629 | 4  | 4  | Country Bills, etc., sent to<br>Branches and Agents . . . . . | 29      | 557 | 19 | 4   |  |   |   |    |    |
| 2,149   | 002 | 17 | 10 | Branch Cheques for Collection                                 | 305     | 287 | 17 | 1   |  |   |   |    |    |
| 63      | 478 | 5  | 6  | Branch Drafts . . . . .                                       | 197     | 329 | 18 | 11  |  |   |   |    |    |
| 920     | 505 | 7  | 9  | Bills Retired . . . . .                                       | 57      | 637 | 5  | 10  |  |   |   |    |    |
| 339     | 260 | —  | 5  | Banker's Payments . . . . .                                   | 41      | 075 | 3  | —   |  |   |   |    |    |
| 14,647  | 391 | 11 | 6  | Current Accounts—   |         |     |    |     |  |   |   |    |    |
|         |     |    |    | Counter . . . . .   | 1,573   | 059 | 12 | 8   |  |   |   |    |    |
|         |     |    |    | Clearing . . . . .  | 16,101  | 671 | 10 | 2   |  |   |   |    |    |
|         |     |    |    | Past Due Bills . . . . .                                      | 53      | 022 | 4  | 1   |  |   |   |    |    |
| 350     | 000 | —  | —  | Loan Accounts . . . . .                                       | 85      | 947 | —  | 3   |  |   |   |    |    |
| 79      | 234 | 19 | 10 | Deposit Accounts . . . . .                                    | 12      | 579 | 8  | 8   |  |   |   |    |    |
| 5       | 366 | —  | 1  | Deposit Receipts . . . . .                                    |         |     |    |     |  |   |   |    |    |
| 1,574   | 236 | 15 | 3  | Country Clearing Account                                      | 1,467   | 342 | 12 | 9   |  |   |   |    |    |
|         |     |    |    | Balance . . . . .   | 369     | 116 | 17 | 5   |  |   |   |    |    |
|         | 75  | —  | —  | Stamped Cheques . . . . .                                     |         | 58  | 10 | —   |  |   |   |    |    |
| 1       | 522 | 3  | 10 | Discount . . . . .  |         |     |    |     |  |   |   |    |    |
|         | 376 | 2  | 1  | Commission . . . . .  |         |     |    |     |  |   |   |    |    |
|         |     |    |    | Interest No. 1 . . . . .                                      |         | 127 | 8  | 6   |  |   |   |    |    |
|         |     |    |    | 2 . . . . .   |         | 98  | —  | 10  |  |   |   |    |    |
|         | 205 | 1  | 7  | 3 . . . . .   |         |     |    |     |  |   |   |    |    |
|         |     |    |    | Incidental Charges . . . . .                                  |         | 37  | 8  | 2   |  |   |   |    |    |
|         |     |    |    | Salary Account . . . . .                                      |         |     |    |     |  |   |   |    |    |
|         | 829 | 4  | 5  | Clearing Difference . . . . .                                 |         | 563 | 1  | 9   |  |   |   |    |    |
|         | 367 | 8  | 2  | Country Clearing Difference .                                 |         | 149 | 11 | 5   |  |   |   |    |    |
|         | 49  | —  | 8  | Walks Difference . . . . .                                    |         | 12  | 19 | 6   |  |   |   |    |    |
| 1       | 002 | —  | 7  | Metropolitan Clearing Differ-<br>ence . . . . .               |         | 27  | 2  | 4   |  |   |   |    |    |
| 72      | 591 | 4  | 3  | Paymaster-General Receipts                                    |         |     |    |     |  |   |   |    |    |
|         |     |    |    | Difference . . . . .  | 104     | 361 | 16 | 9   |  |   |   |    |    |
| 5,286   | 398 | 12 | 8  | Balance of Cash . . . . .                                     | 7,154   | 755 | 15 | 8   |  |   |   |    |    |
| £36,883 | 247 | 17 | 1  |   | £36,883 | 247 | 17 | 1   |  |   |   |    |    |

have been correspondingly reduced. To avoid confusion, therefore, in the following explanation of the foregoing summary, reference is made to the entries as they would be made in the opposite general ledger account.

The head office account is used to debit all branch remittances paid, drafts, payments, etc., drawn by branches on head office paid, and stocks and shares purchased for branches. The credit entry consists of remittances sent to, and received from, branches, cheques drawn on the bank's account at the Bank of England, and stock sold for branches.

"Country Agents" is an account for recording remittances of a special nature, when it is undesirable that they should be placed in the principal remittance account. The entries are the same as in the case of the country cheques. "Country Cheques" may be termed a form of suspense account, inasmuch as it is used to credit country cheques, which are not accepted as cash for certain customers. The customer's account is credited and country cheques account debited, on the third day after they were paid in for collection, unless the cheques have been returned in the meantime. The contra debit to the original credit to country cheques account will be contained in the figure for country clearing, since the cheques are collected through the same channels as ordinary remittances.

When a bank discounts bills there are two methods of dealing with the entries. The first consists of crediting the net amount of the bill less discount to the customer's account, whereas the second, and more general, practice is to credit the customer's account with the full amount of the bill and debit the discount separately. Whichever method is adopted the general ledger entries are the same in principle. The amount of bills discounted is debited to bills discounted account, the contra entry appearing on the credit side of current accounts. When the bills mature, bills discounted account is credited and the various clearings through which the bills are collected

are debited. The clearing departments receive payment from the banks or houses where the bills are domiciled.

“Country Bills, etc., sent to Branches and Agents” comprise those items sent for special collection and advice of payment. The agents or branches are debited when the articles are remitted, and country bills account is credited. On receipt of proceeds, the customer’s account is credited and country bills account debited. Should an article be returned unpaid, reversing entries would be passed crediting the branch or agent and debiting country bills.

“Branch Cheques for Collection” is an internal account for recording amounts outstanding, as between branches and head office, in connection with country clearing remittances. The amount a country branch is due to pay on account of cheques drawn by its customers presented through the clearing, is not debited until confirmation of the sum in question has been received from the branch. Thus, branch cheques for collection account is debited, temporarily, with these amounts, and the credit entry will be found in the figure for country clearing. On receipt of confirmation from the branches adjusting entries are passed crediting branch cheques for collection and debiting the branches. It will be seen that the balance outstanding on this account will represent the amount due from country branches for two days, the time it takes to receive confirmation of the figures.

The next three accounts are similar in operation. Taking branch drafts account as an example, when a branch informs head office that it has drawn a draft, the latter credits the head office account and debits branch drafts account. The draft, it should be explained, will be payable at head office, the entries made when it is presented being to reverse the original record.



Current accounts need but little explanation. The entry on the debit side of the general ledger will contain all cheques drawn by customers that have been paid during the day. It will be noticed that there is a distinction made in the general cash book as between the amount paid through the clearing house and that paid over the counter. The latter sum includes the totals of such items as transfers to deposit accounts, commission, charges, drafts, etc., and other house debits. The waste sheet totals and bills maturing will be grouped on the credit side of the general ledger account.

"Past Due Bills," as its name implies, is an account for recording the amounts of overdue bills, retained either at the request of customers or on the bank's account, in the hope of eventual payment. This account is debited with an overdue bill, the clearing department to which it was originally charged being credited. If the bill is subsequently paid, the past due bill account is credited and the clearing department debited.

Loan accounts embody the various alterations that have taken place during the day. When a loan is granted, the customer's loan account is debited and his current account credited. In the general ledger account, the loans made appear on the debit side, the contra entry being included in the credit of current accounts. On repayment of whole or part of the loan, loan accounts would be credited and current accounts debited.

Deposit accounts and deposit receipts are dealt with in a similar manner to current accounts, inasmuch as all withdrawals appear on the debit side and amounts placed on deposit are found on the credit side.

Country clearing account, as denoted by its title, is concerned with items passing through the country clearing for collection. On the credit side of the general ledger, the

total of cheques in course of collection for any particular day is entered. The amount actually cleared, and for which proceeds have been received, is placed on the debit side.

Stamped cheques account reveals the entries passed in connection with the printing and issuing of cheque books. This account is debited with the cost of the cheque books, and when they are sold to customers, the latter's current account is debited and stamped cheques account credited. The contra entry to the original debit will be a credit to the printing firm's current account.

Discount account is credited with the discount accruing to the bank from bills discounted, and as previously explained, current accounts will contain the debit entries.

There are various methods of distinguishing the interest accounts, and that of the numbers adopted in the specimen summary is perhaps the most simple to understand. Interest No. 1 is confined to interest paid by the bank on deposit accounts and thus appears on the debit side of the general ledger account. The credit entry, of course, will swell the figure for deposit accounts. Interest No. 2 consists of interest paid by the bank on current accounts and by way of rebate on bills, these entries also being placed on the debit side, with the corresponding credits to the customer. Interest No. 3, on the other hand, is a creditor account, since it consists of interest received by the bank on all loans and overdrafts.

Commission and salary accounts may be taken together with advantage, because they are practically self-explanatory. Commission is charged for a variety of banking functions, and is placed to the credit of the general ledger account, current accounts embracing the debit entries. Salary account, on the other hand, represents an expenditure, with the consequence that it invariably

carries a debit balance. It is perhaps unnecessary to add that the credit entries will appear on staff current accounts.

Incidental charges, in a similar way to salaries, are an outgoing item of expenditure, and the account always shows a debit balance.

Then follow the various difference accounts which facilitate the adjustment of the clearing figures, due to errors in listing the cheques. It will be seen in a later chapter how the clearing departments adjust their entries for any particular day. The paymaster-general account is rendered compulsory because several days must elapse before credit is received from the paymaster-general, on account of drafts presented for payment. The amount presented for payment is credited to the general ledger account, and, on receipt of payment, it is debited and the branches or customers credited.

"Balance of Cash" is primarily an account revealing the operations of bank cash during the day. Bank cash includes bank notes, country notes, and coin, the variations of which are obtained from the goldsmith's book. It is the general practice of banks, in connection with big accounts, to credit uncleared articles, such as cheques paid in too late to be cleared that afternoon, and postal orders. Therefore, it is necessary to include the total of such uncleared articles in the balance of cash. On the debtor side of the general cash book, the total of the previous day's cash is entered, the day's cash total figuring on the credit side. Combined on the debtor side are all uncleared articles.

The foregoing explanation reveals the great number of impersonal accounts that have to be conducted at the principal office of a clearing bank, in order to adjust the daily entries for articles in transit. The general ledgers kept at branches present no such complex features as the

one just outlined, since the entries are straightforward debits or credits in account with head office.

Finally, a few words must be added to this chapter concerning Suspense Interest Accounts. Mention has been made earlier<sup>1</sup> of the precautions adopted by banks in general regarding bad and doubtful debts, and it is necessary to explain the book-keeping entries that are passed.

When a loan falls within the category of "bad and doubtful" debts, and it is decided to place interest charges to a suspense account, an impersonal account would be opened as follows—"London Bank Account interest suspense, *re* John Brown, Ltd." In a small office this account will be placed with other impersonal accounts at the end of the last current account binder, but in a large office such accounts may be found in a separate binder. Whichever method is adopted the important point to remember is that the balances outstanding are included in the summary figures for current accounts taken to the general ledger.

The system followed, therefore, when interest charges fall due is to debit the customer and credit suspense interest account, thus adhering to the rules of double entry, without including the sum in the interest account. In this way the charges are recorded on the customer's account, but the final profit and loss account of the bank will not have received the benefit of such profits.

<sup>1</sup> Pages 47 and 48.

## CHAPTER VII

### THE CLEARING DEPARTMENTS

THE clearing system is by no means peculiar to banking. It operates in widely different branches of commerce, and the advantages gained thereby are similar. Rapidity in handling, avoidance of many small settlements, ease of account, and saving of labour are distinguishing features of any clearing system.

In regard to banking, however, it may justly be said that there exists no more highly developed and organized clearing system than that which is represented by the London Clearing House. The remainder of this chapter will be devoted to explaining the entries involved when cheques and other articles are cleared.

There are three distinct clearings, Town, Metropolitan, and Country, the first-named being divided into morning and afternoon clearing, while the others are held once each day. Before the individual clearings are dealt with, it would perhaps be of interest if a few details were given about the London Clearing House.

### LONDON CLEARING HOUSE

The membership of this house is confined to ten clearing banks, and between them they elect a committee of management. This committee, in turn, appoints inspectors, under whose aegis the clearing house functions. The actual building which houses the clearing system, gives but little indication of the enormous sums of money, represented by cheques, etc., that change hands daily. Its appointments are by no means luxurious, consisting

chiefly of a large number of adding machines, with adjoining desks for balancing purposes. Each bank is allotted a certain number of machines and a corresponding amount of desk space. So much for the essentials of the London Clearing House, and now it is time to examine the working of the separate clearings.

### TOWN CLEARING

By far the most important section of the clearing system is the town clearing, which may be described as a reflex of the London Money Market. Because of the influence of purely financial operations, the town clearing in no way reflects the general trade conditions of the country. The town clearing embraces no particular area; the ease with which a bank or branch is reached from the clearing house is the chief concern of the committee of London clearing bankers when deciding whether it should be placed in the town clearing or not. It is necessary to explain the procedure followed when a bank has several branches in the town clearing area. These branches are not distinguished from the head office for town clearing purposes, and all drafts drawn on them are presented by other banks to the head office at the clearing house. When the drafts are taken back to head office, they are rapidly sorted and then conveyed to the various branches by special messengers. As the time allowed by clearing house rules for returning a cheque unpaid is very brief, it follows that the utmost expedition must be used in transferring the cheques from the clearing house to the head office, and from the head office to the branches. If a branch has an article to return unpaid, in most cases it has to return it direct to the presenting bank at the clearing house, because time will not allow of it being taken to head office first. In this contingency the

branch must inform head office of the amount of the cheque, in order that the latter can balance with the presenting bank.

With regard to a town clearing branch presenting cheques for payment, they must first of all be sent to head office with a total and a list of the items, and then head office will present them at the clearing house. In times of stress a branch may present cheques direct to the banker on whom they are drawn at the clearing house, furnishing head office with a list as before.

We now come to the explanation of the operation of the town clearing, which, devoid of unnecessary details, is very simple to follow. The presenting banks list all cheques and drafts drawn on other clearing banks on what are known as "Out Clearing" sheets. When the expression "listing" is used, what is really intended is that the articles are machined and the machined lists are attached to the sheets, with the total entered thereon. The articles are then taken to the clearing house by juniors, who are commonly called "runners," and delivered at the desks of the banks on whom they are drawn. It should be mentioned that before being machined the cheques, etc., are sorted into groups of the various banks represented at the clearing house. The composition of the morning charges, as they are called, is made up of all remittances from branches received by post that morning, all bills of exchange that have been passed forward by bill department the previous day as being due the following day, and any "After Clearing" of the previous day, which consists of articles that missed the clearing the day before.

The afternoon charges consist of articles paid in by customers of head office, together with the cheques received from town clearing branches. The same process is followed as with the morning charges, except that it

has to be carried out with greater rapidity, since cheques paid in at 3.30 p.m. have to be delivered at the clearing house before 3.50 p.m. After the cheques have been machined at the clearing house, they are taken back to the head office of the paying bank by the runners on their return journeys. The clerk at the clearing house attaches his machining to "In Clearing" sheets, and then awaits the arrival of a clerk from the presenting bank with the "Out" sheets.

It is the rule of the clearing house that the "Out" side must seek out the "In" side for balancing purposes. Another rule of the house is that in the event of a discrepancy between the machining of an article on the two sides, the "In" side, or paying banker, is deemed to be correct for the purposes of the overnight balance. The amount over which a discrepancy arises is called a "marker," and the presenting bank on the following day, searches for these markers, in the waste sheets, where it can verify the amount. If the "Out" side is discovered to be correct, the bank will address a request to the paying bank for adjustment of the balance. The paying banker can verify the amount by reference to the town sheets.

It must be observed that the above description applies only to the afternoon clearing, and we have now to deal with the balance of the morning clearing, consisting mainly of remittances from branches. Instead of taking the "Out" sheets down to the clearing house the presenting bank takes down the remittance slips, as listed by the branches, together with a summary showing the total amount claimed from each clearing bank. The remittance slips are so placed at head office when the branch letters are opened that they correspond with the order of cheques presented to any one bank for payment. This facilitates the final balance, and enables cheques to be passed on to



the head office of the paying bank before the complete number of charges has been balanced.

When one or the other bank inadvertently misses a cheque in the machining of a charge, the "Out Clearer" must deduct the amount of it from his total if the "In Clearer" has not listed it, and the former marks the item as a "he has not." If the "Out Clearer" has omitted the cheque, he must add it on to his total and call it a "he has."

The totals of the morning town clearing are carried forward to the afternoon town clearing as the latter is really a continuance of the former. By this method the final settlement is left until the end of the day, and unnecessary entries saved. It will be seen in dealing with the other clearings that all the totals are brought into one balance sheet and only one entry is needed to effect a settlement for the balance of all the clearings combined.

### **METROPOLITAN CLEARING**

The metropolitan clearing embraces no particular area, and, as with the town clearing, the boundary lines are determined more by special conditions than by actual distance. The chief requisite of a metropolitan branch is its accessibility to and from head office; this is rendered important, because it is necessary for a branch to be able to send a messenger to head office to obtain the charge and return to the branch in sufficient time to allow the articles to be cancelled.

All the branches of a bank remit metropolitan clearing cheques to head office by post, and head office presents them through the clearing house the same day as they are received. The following is the procedure at head office. The first charge to the clearing house consists of cheques that have been paid in at head office the previous

day. By 9 a.m. the work is well forward, and it is possible to send another charge over to the clearing house soon after the overnight charge has been delivered. When all the charges have been dispatched to the clearing house the totals of the remittance slips that are attached by the branches to the cheques are machined, and thus a summary is prepared of the amount to be collected from every bank at the clearing house.

It must not be thought that the runners have been returning empty-handed from the clearing house. They have been bringing back to head office cheques, etc., that have been presented by other banks. Each bank has a staff at the clearing house sharp at 9 a.m. to start machining the charges, and as they are machined the sub-casts are agreed if possible; then the runners collect the cheques and return with them to head office. When the charges are delivered at head office, the cheques are immediately sorted into the various metropolitan branches on which they are drawn. These cheques are machined in duplicate, one list being sent down to the branch concerned and the other being retained by head office. When the final charge has been brought over and the cheques sorted and machined, a total is given to each branch of the amount it is being charged with. The cheques on any one branch are tied up together with the machined list and handed to a messenger from that branch, who has probably been clamouring for his charge for some time.

There is no afternoon metropolitan clearing, the work of machining the charges and agreeing them being completed by about 11 a.m., the staff then becoming available to augment those engaged on the country clearing. The system of balancing the metropolitan charges is closely analogous to that of the morning town clearing. The "Out" side seeks out the "In" side, and comes equipped

with the remittance slips sent up by branches, with which the machined lists of the "In" side are agreed. When the charges are finally agreed, a summary is made by each bank of the "In" and the "Out" sides, but a balance is not struck, because the totals are brought into the final town clearing balance at the end of the day.

It must be particularly noticed that the town and metropolitan clearings are not confined to cheques alone, and thus it is found that bills and other articles domiciled with a clearing bank are passed through these clearings. There is an important distinction between the two clearings however, for whereas it is permissible to pass bills with documents attached through the metropolitan clearing, this is not so with the town clearing. In the latter it is necessary to use what is known as a "clearing docket," which is addressed to the banker with whom the bill is accepted payable. This "clearing docket" is a form of receipt, and the banker to whom it is addressed signs it and retains the bills and documents. The "clearing docket" is then passed through the town clearing in the ordinary way, and if the bill and documents are in order it is paid. If the documents are out of order, the general practice would appear to be to send them back specially to the presenting banker. It is unnecessary to make out any dockets for the metropolitan clearing, the reason being that it would entail quite a considerable journey in the first place to get the paying banker's signature on the receipt, and it might be impossible to return the documents direct the same day if they were out of order.

## COUNTRY CLEARING

Country clearing differs from the other two clearings in that it is possible to use it for cheques only, bills, promissory notes, etc., all being barred. All the other

articles have to be sent direct either through country agents or else through country bills remitted.

The country clearing is more sensitive to the conditions of general trade of the nation than either of the other two clearings, because it includes all the branches of the various banks that lie outside the Metropolitan area, and thus is thoroughly representative of the country as a whole.

The remittances of country clearing cheques from the branches are dealt with in the same way as with the Metropolitan clearing articles, but there is a sharp distinction in the method of balancing at the clearing house. In the case of Metropolitan cheques, where they are taken down to branches by messenger the same morning, payment is made on the day the articles are entered at the clearing house, but with country clearing cheques it is impossible to send them to branches by messenger: they have to be posted that night. Payment in the country clearing, therefore, does not take place until two days after the work is entered, and there is time to adjust any difference arising before the settlement. In consequence of this, individual banks do not agree the charges amongst themselves, but each bank enters the totals of the charges on the debit and credit sides, which having been amended, if necessary, during the course of the two days, the balance is struck and carried on to the town clearing sheet.

## THE ACCOUNT OF THE CLEARING BANKERS

The town clearing sheet is the focus to which clearing house figures converge, and the debtor or credit balance of this sheet at the end of the day is the balance that a bank is called upon to pay or receive on account of all articles passed through the clearing house. It was pointed out in an earlier chapter that the clearing system cannot be exploited to best advantage without the aid of a

medium, such as the account that every bank keeps with the Bank of England, and the account of the clearing bankers, which is the one we are more particularly concerned with here.

It is the account of the clearing bankers through which the Bank of England passes the individual balances of the various banks, and its authority is contained in forms, illustrations of which are given. It follows that if the figures are correct the Bank of England should receive the exact amount it has to pay on the account of the clearing bankers, but the volume of articles passing through the clearing house is too great to permit of absolute accuracy, and for this purpose the inspectors of the clearing house have to make a final balance-sheet for the whole of the clearing house. The inspectors are empowered to leave a small difference, but anything in the nature of a large difference must be found, and settled by means of a second transfer on the Bank of England account. Each clearing bank either pays or receives an amount which is debited or credited to its individual account with the Bank of England, the entries being reversed in the account of the clearing bankers.

If the bank has to receive any amount on the day's transaction the clerk writes a green ticket as follows—

#### SETTLEMENT AT THE CLEARING HOUSE

LONDON ..... 19..

To the Cashiers of the Bank  
of England.

Be pleased to *credit* our Account  
the sum of £10,000 out of the  
money at the credit of the account  
of the Clearing Bankers.

£10,000.

Seen by me.

*Inspector at the Clearing  
House.*

BANK OF ENGLAND,  
..... 19..

The account of  
Bank has this evening been  
credited with the sum of £10,000  
out of money at the credit of the  
account of the Clearing Bankers.  
£10,000.

*For the Bank of  
England.*

If the bank has to pay on account of the difference a white form is made out as follows—

## SETTLEMENT AT THE CLEARING HOUSE

LONDON . . . 19..

To the Cashiers of the Bank  
of England.

Be pleased to transfer from our  
account the sum of £10,000 and  
place it to the credit of the Ac-  
count of the Clearing Bankers and  
allow it to be drawn for by any of  
them (with the knowledge of  
either of the Inspectors signified  
by his countersigning the drafts).  
£10,000.

BANK OF ENGLAND,

. 19..

A transfer for the sum of £10,000  
has this evening been made at the  
Bank from the Account of  
to the Account of the  
the Clearing Bankers.

*For the Bank of  
England.*

£10,000.

This certificate has been seen  
by me.

*Inspector.*

## WALKS CLEARING

Confusion often arises through the classification of walks department as a clearing department, because there is no walks clearing at the clearing house. The similarity that exists between the object of walks department and the object of a clearing department is, however, sufficiently close to justify the expression walks clearing.

There are grouped about the City of London many offices of foreign and colonial banks, merchant banks, acceptance houses, etc., and the majority of these houses open accounts for their customers and allow them to be drawn on by cheque. These cheques, not being drawn on a clearing banker, cannot be passed through the clearing house for collection, and the practice is accordingly to collect through walks department. At the head of the non-clearing institutions is the Bank of England, which presents cheques through the town clearing but does not receive them. In the Metropolitan and country clearing, the Bank of England both presents

and receives cheques. All cheques and other articles drawn on the head office of the Bank of England are charged to walks department and collected by it. Amongst other articles collected by walks department may be mentioned postal orders, drafts on the General Post Office, money orders, Inland Revenue drafts, and drafts drawn on departments of State such as the Admiralty, Paymaster-General, etc. Walks clerks also take bills to private firms or individuals within a certain area, and collect the proceeds either by cash or, if the firm is of good standing, by cheque.

The various branches remit walks articles under separate cover in their head office letter, and also segregate the Paymaster-General drafts. The branches enter a separate total for these drafts on their walks remittance sheets, but it is combined into a grand walks total. The reason for this is that the Paymaster-General drafts are balanced separately at head office, because some days elapse before they are paid. The actual walks are split up into various districts, and vary in each bank; the walks clerk deals with any collection within his area, and may have extra duties to perform, such as taking bills to be accepted or documents to be paid.

Every walks clerk is provided with a notebook, in which he keeps a list of the places where he has to call and a total of the cheques deposited at each institution. The articles are sorted and 'machined' first thing in the morning, and the clerk then makes up his notebook and pins a slip to each charge with the total incorporated thereon; he then proceeds to take these charges out, and in the afternoon picks up a banker's payment or cheque in payment thereof, together with any returned cheques. The various walks are then specified on sheets, the town clearing payments being listed on a machine and the

machining pasted on the sheet, whilst the payments or cheques on the Bank of England are listed separately, as are the returned articles. Lastly, the cash received by a walks clerk during the day is entered on the sheet, which is balanced with the total entered in the notebook. The town clearing articles are charged to town clearing, and handed to them in time for the afternoon clearing, the Bank of England payments are taken down by a special runner, and the cash is paid into the cashier's department. The unpaid articles are charged to unpaid bill department, which deals with the unpaids of all the clearing departments. Walks articles paid in for collection at head office during the day are sorted and listed overnight, the totals being carried forward the next morning to the machining of the branch cheques.

### UNPAID ARTICLES

The method of returning a walks cheque has been stated, but with regard to the returning of cheques presented through the clearing house it has been considered easier to understand if they be grouped together under one heading. Dealing with the unpaid articles in the same order as we discussed the clearings, we must first examine the method of the town clearing.

Since there is a morning town clearing, it follows that many cheques that are out of order are discovered quite early in the day at the office of the paying banker. These unpaid cheques are returned in the afternoon town clearing and are machined in the charge as though they were cheques paid in for collection. The bank at the clearing house is made aware of the fact that a cheque is a return by its being placed face downwards, and he accordingly marks the item with an "R" in his machining, keeping it out separately for dispatch to the head office



by one of the runners. When it is too late to return cheques or other articles in this manner, they are charged separately and taken over by a special runner ; the totals of these returns are balanced at the clearing house in the same way as ordinary charges. Both sides of the returns, debit and credit, are carried forward to the end of the general balance sheet, these being the final entries on the sheet.

Unpaid metropolitan clearing drafts must be returned by post on the day of presentation, direct to the bank or branch bank whose name and address is on the crossing. The method of obtaining reimbursement for an unpaid cheque, which, of course, has been provisionally paid, is by passing a debit slip for each separate article, giving full particulars through the town clearing on the day of settlement. In dealing with returned articles in the metropolitan clearing, it must be particularly noticed that there is imposed on the paying banks a special condition with regard to unpaid bills and bills not due. The rules of the clearing house require such bills to be returned by post on the day of the presentation to the *head office or London agent* of the presenting bank, and the crossing branch or bank notified by post the same night, quoting reason for dishonour.

All returned cheques presented through the country clearing, or, to give it the correct title, the country cheque clearing, must be sent direct to the branch or bank whose crossing appears on the cheque. A branch returning a cheque informs head office of its action, the amount being adjusted with the head office of the presenting bank.

## CHAPTER VIII

### DEPOSIT, LOAN, AND BILL ACCOUNTS

THE entries to be explained in this chapter are of a straightforward nature, inasmuch as they concern the bank's assets on the one hand, and its liabilities on the other. Taking the latter first, we have already explained the entries in connection with one type of liability, current accounts, and it is now necessary to deal with the deposits which are theoretically not withdrawable on demand.

#### DEPOSIT ACCOUNTS

There are three forms of deposit accounts : (1) repayable on demand ; (2) repayable subject to specified notice ; (3) fixed deposits. The differences between these types have already been indicated, and it only remains to add that the actual entries passed do not differ, but it is the rate of interest paid by the bank for the funds that is the variable factor.

A customer can appropriate funds to his deposit account in one of two ways. He can either pay cheques, dividend warrants, etc., to his credit in a similar manner to current account credits, or he can authorize a transfer, debiting his current account and crediting deposit account. This authorization may be contained in a letter, but must be signed with the customer's usual signature. If cheques are paid in to the credit of a deposit account they are passed through the waste book and charged to the various clearing departments in the ordinary way. When a transfer is made from current account to deposit account, the entries are passed through the transfer book.

When the former method is adopted to allocate funds, the entries the bank makes are obtained from the docket that is filled in with all credits to deposit accounts. The cashier records the brief details of the transaction in his received cash book, the waste book entries are then made, and the docket is entered in a deposits diary ruled as follows—

## DEPOSITS DIARY

| Date | Name of Customer | Rate of Interest | Folio | Amount |    |    | Due Date | Repaid Date |
|------|------------------|------------------|-------|--------|----|----|----------|-------------|
|      |                  |                  |       | £      | s. | d. |          |             |
|      |                  |                  |       |        |    |    |          |             |

Transfers from current account, after being entered in the transfer book, are specified in a separate deposits diary, ruled exactly the same as above. The final entry is made in the deposit ledger, a specimen ruling of which is given on page 91.

When deposits are withdrawn, the customer either signs a withdrawal form, or draws a cheque, or authorizes his deposit account to be debited and current account credited. With the first two methods, the cashier enters the details in his paid cash book and passes on the dockets or cheques to be entered in a deposits paid register before the final entry is made in the customer's ledger account. With transfers from current account to deposit account and *vice versa*, the entries are originally made in the transfer book in lieu of the cashier's books, but the procedure is similar subsequently.

# DEPOSIT LEDGER

| Date    | Particulars           | Dr.    | Cr.                 | Cr.<br>Balance      | Days | Rate<br>of<br>Interest | Interest<br>Due by<br>Bank | Interest<br>Checked<br>by |
|---------|-----------------------|--------|---------------------|---------------------|------|------------------------|----------------------------|---------------------------|
| 19..    |                       |        |                     |                     |      |                        |                            |                           |
| Dec. 31 | By Balance . . .      | £      | £ s. d.<br>150 10 4 | £ s. d.<br>150 10 4 | 10   | 2                      | £ s. d.<br>1 1 7           |                           |
| 19..    |                       |        |                     |                     |      |                        |                            |                           |
| Jan. 10 | From Current A/c.     |        |                     |                     | 38   | 1½                     | 5 1                        |                           |
| Feb. 17 | „ Chqs. . . . .       |        | 15 6 -              | 165 16 4            | 2    | 1½                     | - 6                        |                           |
| 19      | „ Self . . . . .      |        | 94 - 3              | 259 16 7            | 35   | 1½                     | 4 11                       |                           |
| Mar. 25 | „ From Current A/c.   | 75 - - | 20 10 8             | 184 16 7            | 6    | 1                      | - 9                        |                           |
| 31      | „ Int. to Current A/c |        |                     | 205 7 3             |      |                        | £ 12 10 -                  |                           |

Interest paid on deposits in London depends upon the terms under which they are lodged, but in the specimen ledger ruling it will be seen that the rate has changed twice. This indicates that it is not a deposit at a fixed rate of interest, but is repayable on demand or at short notice, in which case interest varies with bank rate. Interest is worked whenever the balance standing to the credit of a customer is altered, or when bank rate changes. It has been assumed in the specimen working of interest, therefore, that the changes in bank rate were on 10th January and 25th March, thus coinciding with transfers from current account.

It is the general practice in banking to ignore shillings and pence in the principal sum when working such calculations as interest, discount, and rebate.

There remains to be considered the deposit book or receipt that is issued to customers as evidence of the debt due from the bank. In the earlier days of banking, it was the general practice to issue a deposit receipt for every payment to credit, and not to repay the money they represented unless the receipts were presented by the customer. These receipts are not transferable, but they possess certain disadvantages over the modern form of statement, and as a consequence their use has been discouraged. The deposit book issued to a customer is ruled similarly to a pass book, but it must be produced by the customer when operating on the account, unless it is already in the possession of the bank.

The general ledger entries in connection with deposit accounts are as follows. Withdrawals will appear on the debit side of deposit accounts, and amounts placed on deposit will be received on the credit side. Interest paid on deposit will appear as a credit entry, either to deposit accounts, or to current accounts, according to

the customer's instructions, while the debit will be entered in Interest No. 1 account.

Under normal conditions, when bank rate is low the aggregate amount of deposits tends to drop, since money seeks the more productive fields of Government securities and other investments yielding a higher return than the London deposit rate. Since the crisis of 1931, however, industrial activity has been curtailed, new enterprises have been stifled, and conversion schemes have been instituted, all tending to restrict the circulation of money. These unnatural causes have produced the extraordinary result of London deposit rate being at the lowest figure of one half per cent, yet even this meagre inducement has caused deposit figures to soar.

The deposits in the country do not vary to the extent of those in London, chiefly because the rate of interest is not so elastic. The flat rate of two and one half per cent was in force for some time before the crisis, but considerable scaling down has occurred since that date.

## LOAN ACCOUNTS

Loans to customers represent the largest proportion of a bank's assets. All loans granted, therefore, constitute assets and appear on the debit side of the general ledger. When a loan is sanctioned an account is raised in the name of the beneficiary in the loan ledger, the amount of the loan being debited to this account and credited to the customer's current account. The entries, in common with most bank book-keeping, are made from slips, the latter having first been recorded in a day book or journal. Conversely, when a loan is repaid, either in part or in full, the entries passed through the day book and ledger will be a credit to loan account and a debit to current account. The debit to current account in the last

operation may not be a slip, since a customer not infrequently gives the bank a cheque for the amount.

The ruling of a loan ledger needs no special illustration owing to its similarity to that of the deposit ledger. The headings, however, are different in two instances, the balance being always debtor, and interest being due to the bank.

In regard to interest, it is the general practice to debit current account with the amount due on loan account; this arrangement is stipulated at the time the loan is under consideration. The entries passed when calculating interest for any given period consist of a debit to current account and a credit to interest No. 3 account in the general ledger. In special circumstances, the bank agrees to debit the interest payable on the loan to loan account, thus increasing the amount of the customer's indebtedness.

The balancing of deposit and loan account ledgers is not such a difficult task as agreeing the current account ledgers, since the number of entries bears no comparison and the balances are all either credit for deposits or debit for loans. These ledgers are balanced with the general ledger every week.

The subject of loans is closely connected with that of securities. It would be unnecessary to explain the various types of security in this book, but an indication may perhaps be afforded of the system of registering the various details. These entries are, of course, purely for record purposes, and form no part of the entries combined in the general ledger.

In some banks the details concerning the security deposited against a loan are entered in the loan ledger, but in a large office this is not practicable, and a loose-leaf index record is kept, showing the following data.

## SECURITY DEPOSITED REGISTER

JAMES SNAITH

| When De-<br>posited | Description                   | Market Value |    |    | Loan Limit |    |    | Remarks             |
|---------------------|-------------------------------|--------------|----|----|------------|----|----|---------------------|
|                     |                               | £            | s. | d. | £          | s. | d. |                     |
| Feb. 7              | 100 Courtaulds Ord.<br>Shares | 150          | —  | —  | 125        | —  | —  | Blank transfer held |

When a bank takes securities from a customer for safe custody only, it merely keeps the records that any baillee would keep. Thus, securities deposited for this purpose would be entered in a securities received register, and a securities delivered register would cover the withdrawals from safe custody.

SECURITIES RECEIVED  
DELIVERED REGISTER

| When Received<br>Delivered | Name | Amount of Security |    |    | Description | Received from<br>Delivered to |
|----------------------------|------|--------------------|----|----|-------------|-------------------------------|
|                            |      | £                  | s. | d. |             |                               |
|                            |      |                    |    |    |             |                               |

## BILL ACCOUNTS

Bills discounted form another large asset of the bank, indicating that the general ledger account of this name will always be debited with the amounts in question. When bills are discounted for a customer the current account of the latter is credited and bills discounted account debited. At maturity, bills discounted account is credited and the various clearing departments debited. In the interim it is necessary to keep a record of the amounts discounted for any one customer, the maturing



bills on any particular day, etc. The books recording these details are shown on pages 97-99.

The day book is self-explanatory except for the rebate section. Most banks in this country have their half-yearly balance on 31st December and 30th June. It follows, therefore, that only the amount of discount actually earned in any current period is available as profit for that period. For example, if a bill due on 25th January is discounted on 2nd December the total discount will be worked out in the ordinary way, but 25 days' discount is earned in the next half-year. It will be necessary to make a separate calculation in the rebate columns ascertaining this amount, and when the books are ruled off the rebate total must be deducted from the discount total. It will be obvious that the rebate total for any one period is carried forward as discount for the succeeding period.

The entries passed in connection with the discount have already been explained, and it only remains to add that the total discount earned in the current half-year is transferred to profit and loss account at head office when the books are ruled off. The amount of rebate is brought into the discount account in the general ledger as the opening item for the next period. This total is also carried forward in the day book to the new period.

The ledger presents no difficulty of understanding, since its purpose in recording the amount of bills discounted outstanding for any one customer is clearly shown. The details entered in this book are not so extensive as the day book entries, but they are sufficient to indicate any particular bill.

The diary is a book utilized to post the bills in due date order, thus ensuring that they are presented for payment at their respective due dates.

# BILLS DISCOUNTED DAY BOOK

| Date            | Name of Customer                               | Cus-<br>tomer's<br>No. | Acceptor   | Where<br>Payable               | Date<br>of<br>Bill                      | Tenor                        | Due<br>Date                              | No.               | Amount |    |    |
|-----------------|--|------------------------|--|--------------------------------|---|------------------------------|--|-------------------|--------|----|----|
| 19..<br>Jan. 10 | Smith, Jones & Co.<br>Ltd.<br><br>Brown Bros.. | 137<br><br>415<br>82   | London Bank<br><br>Parkers Ltd.<br>Velours & Co. | E.C.<br><br>Hendon<br>Bradford | 19..<br>Jan. 8<br><br>Dec. 24<br>Jan. 1 | 15 d/s<br><br>2 m/d<br>1 m/s | 19..<br>Jan. 27<br><br>Feb. 27<br>Feb. 5 | 516<br><br>7<br>8 | £      | s. | d. |
|                 |  |                        |  |                                |   |                              |  |                   | 1,000  | —  | —  |
|                 |  |                        |  |                                |   |                              |  |                   | 26     | 5  | —  |
|                 |  |                        |  |                                |   |                              |  |                   | 100    | —  | —  |

| Amount of<br>Credit |       | Daily<br>Amount |       | Rate<br>% |    | No.<br>of<br>Days |  | Discount |       | Daily<br>Discount |       | No.<br>of<br>Days |  | REBATE |       |
|---------------------|-------|-----------------|-------|-----------|----|-------------------|--|----------|-------|-------------------|-------|-------------------|--|--------|-------|
|                     |       |                 |       |           |    |                   |  |          |       |                   |       |                   |  | Rebate | Total |
| £                   | s. d. | £               | s. d. |           |    |                   |  | £        | s. d. | £                 | s. d. |                   |  | £      | s. d. |
| 1,026               | 5 -   |                 |       | 3 1/2     | 17 |                   |  | 7 9      |       |                   |       |                   |  |        |       |
|                     |       |                 |       | 2 1/2     | 48 |                   |  | 1 9      |       |                   |       |                   |  |        |       |
| 100                 | - -   | 1,126           | 5 -   | 2         | 26 |                   |  | 2 10     |       | 11                | 7     |                   |  |        |       |

# BILLS DISCOUNTED LEDGER

SMITH, JONES & CO., LTD.

| Date    | No. | Acceptor       | Where Payable | Rate %         | Due Date | Amount |    | Cr. by Bills Falling Due |    | Balance |    |
|---------|-----|----------------|---------------|----------------|----------|--------|----|--------------------------|----|---------|----|
| 19..    |     |                |               |                | 19..     | £      | s. | £                        | s. | £       | s. |
| Jan. 10 | 516 | London Bank.   | E.C.          | $\frac{1}{2}$  | Jan. 27  | 1,000  | -  |                          |    | 1,026   | 5  |
| Jan. 27 | 7   | Parkers, Ltd.. | Hendon        | $2\frac{1}{2}$ | Feb. 27  | 26     | 5  | 1,000                    | -  | 26      | 5  |

# BILLS DISCOUNTED DIARY

27TH JANUARY, 19..

| For whom Discounted      | No. | Acceptor    | Amount      | Town Clearing | Walks | Metropolitan Clearing |
|--------------------------|-----|-------------|-------------|---------------|-------|-----------------------|
| Smith, Jones & Co., Ltd. | 516 | London Bank | £ 1,000 - - | £ 1,000 - -   | £ - - | £ - -                 |

Bills payable in the provinces are entered separately as it is necessary to send them forward specially for collection by post two days before they mature. Country clearing only deals with cheques.

# ACCEPTORS LEDGER

LONDON BANK

| Date            | For whom Discounted         | Drawn by                         | Endorsed by                 | Due Date        | Amount     | Written Off | Balance    |
|-----------------|-----------------------------|----------------------------------|-----------------------------|-----------------|------------|-------------|------------|
| 19..<br>Jan. 10 | Smith, Jones<br>& Co., Ltd. | South American<br>Meat Co., Ltd. | Smith, Jones<br>& Co., Ltd. | 19..<br>Jan. 27 | £<br>1,000 | £<br>1,000  | £<br>1,000 |
| 27              |                             |                                  |                             |                 |            |             | nil        |

The acceptors ledger records the bills discounted on any particular name, and in this way forms a useful guide as to how the bills are spread. It is customary in some banks to ignore the shillings and pence when posting amounts to this book, since they form no integral part of a bank's book-keeping system.

Reference to the general cash book summary in Chapter VI will reveal that there are three bills discounted accounts in the general ledger in the large city offices. It must be emphasized that these divisions occur only when the volume of bills discounted is considerable. Bills discounted account includes the bills bought from the bank's ordinary trading customers, such as the examples in the specimen set of books in this chapter. This particular class of bills will be allocated a separate day book, ledger, and diary, and given a distinctive number. Bills drawn on trading firms predominate in this section of the work. Bills discounted "brokers," as indicated by the title, refers to the bills purchased from the market. These bills are, generally speaking, first-class bank paper and Treasury bills, the latter predominating in amount. The Treasury bills obtained by the bank in the weekly tender are included under this heading. Separate books are employed to record all broker's bills. Bills discounted "foreign" represents those bills payable abroad that are discounted for customers, such transactions being generally termed "sterling negotiations." This type of bill is only discounted for substantial customers, owing to the difficulty of obtaining adequate information about the standing of acceptors abroad.

The general ledger balances outstanding against these accounts are agreed weekly with the summaries of the various ledgers.

There is another type of bill account which must be

considered, although it in no way affects the assets of the bank except in so far as a lien exists. We refer to bills for collection. Since these bills are held by the banks on behalf of their customers, it follows that no alteration in the bank's position is involved when such items are paid in for collection. The general practice is, therefore, to open an account in the general ledger, termed bills for collection account, and to place to its credit all bills paid in by customers. Another account, styled bills receivable account, receives the contra entry of a debit for the same amount. When the bills mature, bills for collection account is debited and bills receivable account credited.

In a large office bills for collection would be entered in a day book, ledger, and diary. The day book would be ruled in a similar manner to the discounted bills day book, with the exception of the interest and rebate columns, which are not necessary for collection purposes. The acceptors ledger is not utilized for collection bills, since the bank is merely acting as agent for his customers, and has no financial interest in the bills.

## CHAPTER IX

### DEPARTMENTAL ENTRIES

It is not intended to conduct an exhaustive survey into head office departmental methods, but an outline will be given of the book-keeping records necessary to the organization of the external sections of head office.

#### STOCK DEPARTMENT

This department acts as an *entrepreneur* between the bank's customers and the London stockbrokers. It is chiefly engaged in giving instructions to the various brokers in pursuance of buying or selling orders received from branches. In order to carry out this work a number of dealers are appointed to act independent of each other with their own particular set of brokers. These dealers receive batches of orders each morning from the branches, and they divide them into sales and purchases before making a final allocation of orders they intend to give to their brokers.

Orders from branches are made out in duplicate, the lower half being detached by the dealer and sent to the various brokers in confirmation of the telephoned instructions that have been given earlier. The object of telephoning the bank's buying and selling orders is to ensure that the broker attends the opening of the market equipped with these orders. On completion of the sales and purchases, the brokers send the relative contract notes to stock department.

The orders given to any particular broker are recorded on a daily statement headed with the name of that

broker. When the contract note is received from the broker later in the day additional details regarding the quotation obtained, the amount of the transaction at that price, and the commission charged can be incorporated on the statement. When the entries have been made on the statement, the orders are passed to a ledger clerk for recording in the broker's ledgers; in this way a check is obtained on the entries. The following is a specimen sheet in one of these loose leaf ledgers, and it will be noticed that each entry is ruled off separately.

## SMITH, SMITH, JONES &amp; CO.

| No.  | Buy<br>or<br>Sell | Particulars   | Amount |    |    | Date of<br>Settle-<br>ment | Branch   |
|------|-------------------|---|--------|----|----|----------------------------|----------|
| 1028 | Sell              | £500 Sheffield Corp. 3½%<br>at par<br>Sold at par.    | £      | s. | d. | 19..<br>Mar. 23            | Windsor  |
|      |                   |   | 500    | —  | —  |                            |          |
| 1029 | Buy               | 100 Bowater's Paper<br>Ord. at best<br>Bought at 30s. | 150    | —  | —  | Mar. 23                    | Carlisle |

Stock exchange transactions may be for cash or for settlement. In the event of a customer desiring to make a cash bargain, stock department will pass the necessary entries on the same day as the order is carried out. The majority of transactions, however, are not settled until the day appointed by the authorities of the Stock Exchange. In the absence of any special circumstances, this day occurs on every other Thursday, and all dealings prior to the Monday before each settling day must be completed by payment on the Thursday. Dealings taking place on



or after the Monday prior to a settlement day are for the new account, and will not be settled until the expiration of the next period.

The contract notes received from brokers are dispatched by Stock Department to the branches. The latter informed their customers of the details concerning the price at which the order was executed, and the amount to be debited or credited to their accounts. In some banks it is the practice in regard to purchases to debit customers' accounts two days before settling day, in order that the branches can credit head office with the funds to pay over to the brokers. The majority of brokers with whom a bank deals keep accounts with the city office or a town clearing branch; it is thus a simple matter for head office to pass a transfer entry, crediting the broker and debiting the branch concerned. When amounts are due to be paid from the brokers to the bank, as in the case of sales, the former usually issue cheques covering a series of transactions, specified on a slip attached. Stock department credits the various branches involved in this payment, and advises them in order that they may pass responding entries debiting head office and crediting their customers.

In view of the prominence given recently to the question of a bank's commission on stock exchange business passing through its hands, it may be of interest if we give the method adopted to settle these claims. Stock department credits the broker with the full amount of commission on each transaction, the amount being passed on to the branch and ultimately to the customer. A commission account is kept in the name of each broker, and one half of the commission paid to the broker is entered on the debit side of the account. 50 per cent is still the recognized allowance of commission by a broker to a bank, despite repeated attempts to lower this

proportion. The usual practice is for the brokers to pay the amount outstanding each quarter by cheque, and their commission accounts are then ruled off preparatory to starting a new period. In a similar manner, branches send up quarterly statements to stock department, recording all sales and purchases negotiated on behalf of their customers. They debit head office with the total, and stock department responds to the entries when they have been agreed.

### **REGISTRAR'S DEPARTMENT**

This department is concerned with the recording of share holdings, and as such does not form part of a bank's ordinary accounting scheme. Primarily, the work involved in connection with the bank's own shares is dealt with by this department, and when it is realized that the big joint stock banks have as many as fifty thousand shareholders, it will be seen that the work is not inconsiderable. In addition, the banks keep the books of many corporations, in a similar manner to the Bank of England acting as agent for the Government in this respect.

Registered shares in a bank must be transferred by transfer deed, which is incomplete unless signed and witnessed by the transferee. The transfer deed, together with the share certificate, must be lodged with the bank in order that the necessary amendments be made in the records. The particulars of the transfer are entered in the transfer register, which will be found to contain the details as given on page 106.

The book in which the holdings of shareholders are registered is called a share register. An account is opened in this book for every shareholder of a bank or company, and the outstanding balances should equal the total paid-up capital of that institution. The modern

## TRANSFER REGISTER

| From whom Transferred |                 |  |          | To whom Transferred                              |          |          |         |         |                  |
|-----------------------|-----------------|--|----------|--|----------|----------|---------|---------|------------------|
| No.                   | Date            | Name and Address                                     | Dr. Fol. | Name and Address                                 | Cr. Fol. | Amount   |         |         | Certificate Sent |
| 1578                  | 19..<br>Feb. 19 | James Arthur Dunlop<br>97 Chester Road,<br>Liverpool | 572      | Richard Mann<br>58 Bolsover St.,<br>Macclesfield | 2721     | £<br>500 | s.<br>- | d.<br>- | 19..<br>Feb. 22  |

practice is to employ the loose-leaf and machine system for recording the details of every transfer in the share register. At the head of each account must appear details concerning the full name, address, and occupation of every shareholder, in order to comply with the provisions of the Companies Act, 1929. This Act allows a company to close its books for a period not exceeding in the aggregate thirty days in each year, provided due notice is given in the Press. Banks usually take advantage of this concession in order to prepare the interim and final distributions to their shareholders, no transfers being registered for a short period in January and July.

A common form of share register is shown on the next page.

## NEW ISSUE DEPARTMENT

This department of a bank is responsible for handling the many issues of capital made by companies and corporations. Most people are aware that it is the custom to require a proportion of capital applied for to be paid on application, a further sum on allotment, and the remainder may be spread over a number of calls. In this way a company does not receive the full amount of the subscriptions until two or three months or longer have elapsed from the date of the issue.

**Name.....** *Charles Ernest Heywood* ..... **Address** *127 St. Martin's Road, Catford, S.E.6....* **Occupation.....** *Clerk.....*

| PURCHASED |                              |               |               |             |          | SOLD    |                      |                            |               | BALANCE                    |        |                 |      |
|-----------|------------------------------|---------------|---------------|-------------|----------|---------|----------------------|----------------------------|---------------|----------------------------|--------|-----------------|------|
| Date      | No. of Allotment or Transfer | No. of Shares | Share Numbers | Details     | Folio    | Date    | No. of Transfer Deed | Folio in Transfer Register | No. of Shares | Share Numbers              | Shares | Capital Paid-up |      |
| 19..      | Trans. 7062                  | 100           | C 748/847     | Transferred | T.R. 166 | 19..    |                      |                            |               |                            | 100    | £ 100           | d. - |
| Apr. 10   | " 8269                       | 500           | C 1480/1979   | "           | T.R. 461 |         |                      |                            |               |                            | 600    | 600             | -    |
| May 22    |                              |               |               |             |          | June 10 | 723                  | 28                         | 200           | { C 748/847<br>C 1480/1579 | 400    | 400             | -    |

When applications for a new issue begin to arrive at the bank they are machined and examined. The machined list is carefully watched in order that the lists may be closed when the desired amount of capital has been subscribed. The cheques attached to the applications are agreed as to the amount, and, if in order, they are passed forward for entering on ledger sheets. These ledger sheets record the details of the number of the application, the number of shares applied for, particulars of the cheque or other remittance accompanying the application, and the amount sent. The cheques are then detached and entered in a special waste book, ruled in a similar manner to the ordinary waste sheets. It follows that the final total of the waste book should agree with the total of the ledger summary that is prepared.

If the company making the new issue of capital prefers to allot the shares itself, the bank simply compiles a statement of the applications forwarded. These statements contain the same particulars as the ledger sheets, with the exception of the details about the cheques. On the other hand, many companies request the bank to proceed with the allotting of the shares, and this involves a considerable amount of preparation. The issue may be over-subscribed, in which case it is necessary to decide on a proportion of shares to allot. The first step is to sort the applications into denominations, and to arrive at a total for each batch. It may be necessary to fix a minimum, below which all applications must be ruled out entirely, while allotting a proportion to those above, but the method of allotting varies with each issue owing to the differing views of individual companies.

Whichever method is adopted all applications that receive either full or proportional allotment are listed on large loose-leaf sheets, containing a full record of the

name, occupation, and address of the applicant, the number of the application, the amount allotted, the amount paid on application, and the amount due on allotment. This record forms the basis of the subsequently created share ledgers, and it is generally compiled from applications of the same amount, although in some cases an alphabetical order of applicants is followed.

When an issue is over-subscribed it has been stated that only a proportion can be allotted to the applicants. From this, it follows that the amount remitted by these applicants will be in excess of the application money required on the smaller number of shares allotted. The general practice in cases of this description is to carry forward the surplus amount on application to that required on allotment. To take a concrete example, if Jones applies for 100 £1 shares issued at par, of which £12 10s. is due to be paid on application and £25 on allotment, he may receive a 50 per cent allotment. The amount payable on application and allotment for fifty shares is £18 15s. Jones's cheque would have been £12 10s. on his original application for 100 shares, and on the basis of a 50 per cent allotment he would be required to pay only £6 5s. on allotment. It sometimes happens that an issue is scaled down to such a degree that the amounts remitted as original application money are more than sufficient to cover the application and allotment money on the number of shares actually allotted. The surplus, in this case, is returned to the applicant, and not carried over to the first call.

Evidence of title to shares in a new issue of capital is contained in the allotment letter that is sent to each successful applicant. This allotment letter contains a series of detachable dockets, and when the amount due

on allotment is paid, the bank receipts the relative docket and attaches the duplicate to the remittance accompanying the letter. These dockets are ledgered in a similar manner to the application forms, the cheques being detached and passed through the waste sheets. This process is repeated for any subsequent calls until all the dockets have been receipted or detached, and the issue is fully paid.

In the case of registered shares the company generally exchanges share certificates for allotment letters direct with the holders, but with bond issues the bank frequently undertake the issuing of provisional scrip on behalf of the company. This provisional scrip is issued before the issue is fully paid, and has dockets for the outstanding calls. Holders generally combine the exchanging of an allotment letter for scrip with the payment of a call, and in this case the bank will retain the allotment letter until the cheque for the instalment is cleared, forwarding the scrip to the holder by post.

A considerable number of applications for shares in a new issue are handed in at branches of the bank to the issue. The same applies to the payment of instalments by holders of the shares. In any of these transactions the branch detaches and clears the cheque, the credit being advised to city office on the London letter, which is explained in the succeeding chapter, and the application form or instalment docket being attached to a branch debit addressed to new issues department. This department subjects all applications, etc., received from branches to a similar process as those taken in over the counter. The branch debits are charged to country clearing on the waste sheet, since they are regarded as cheques on the various branches, and eventually the branches receive back their debits in the head office clearing.

## COUPON DEPARTMENT

The work of this department is concerned with the presenting of coupons for payment to the financial agents of a bond issue. This somewhat bare statement conveys but little of the organization necessary to carry out this function of banking.

The bulk of the coupons remitted by branches for collection are detached from securities that have been deposited with the bank against loans. A smaller proportion consists of coupons detached from bonds in safe custody on the instructions of the customer, and the remainder are paid in for collection by customers. About a month before the due date, branches are requested to remit all coupons falling due for payment to coupon department. The bonds to which the coupons are attached are kept in strict order at a branch, and it is not difficult to ascertain from a card index the maturing coupons. When the coupons are detached particulars are entered in a coupon journal, following which they are sorted into coupon envelopes ready for dispatch to head office. A separate coupon envelope is made out for each customer, and the following details specified thereon.

## COUPON ENVELOPE

30TH APRIL, 19..

|                              |         |                         |                |
|------------------------------|---------|-------------------------|----------------|
| Total No. of Coupons } ..... | 10      | Due .                   | 1st June, 19.. |
| of .. . City of Hamilton     | 4½%     | Coupons for Collection. | ...            |
| from .. . Barrow             | Branch. |                         |                |
| A/c .. . Arthur Maynard      |         | £22 : 10 : -            |                |
| Currency } .. . Less Tax     |         | 5 : 12 : 6              |                |
| Foreign }                    |         |                         |                |
|                              |         | <u>£16 : 17 : 6</u>     |                |



Accompanying the coupon envelopes will be found a coupon remittance sheet on which are specified the details of all the coupons remitted in any one envelope. When the envelopes have been prepared for each customer, the details are then incorporated on the remittance sheet.

## COUPON REMITTANCE SHEET

BARROW BRANCH

30th April, 19..

| Title of Loan                 | Total Number<br>of Coupons and<br>Denomination | Total<br>Amount of<br>Coupons of<br>each<br>Denomina-<br>tion |    |    | Total<br>Amount<br>as per<br>Envelope |    |    |
|-------------------------------|--|---|----|----|---------------------------------------|----|----|
|                               |  | £   | s. | d. | £                                     | s. | d. |
| City of Hamilton 4½% .        | 10 @ £2 5s.                                    | 22  | 10 | —  | 22                                    | 10 | —  |
| Metropolitan Water Board 4% . | 5 @ £2 .                                       | 10  | —  | —  |                                       |    |    |
|                               | 10 @ £1 10s.                                   | 15  | —  | —  |                                       |    |    |
|                               | 50 @ £1 5s..                                   | 62  | 10 | —  | 87                                    | 10 | —  |
| Birmingham Corporation 3½% .  | 29 @ £5 10s.                                   | 159   | 10 | —  |                                       |    |    |
|                               | 12 @ £1 15s.                                   | 21  | —  | —  | 180                                   | 10 | —  |
|                               |  | Total   |    |    | £290                                  | 10 | —  |

The total amount of coupons remitted by a branch is entered on the London letter and checked by coupon department the next day.

When the coupons arrive at coupon department, each envelope is checked as to its contents, and the coupons are listed on the special forms provided by the financial agent to the issue. Most institutions insist on the coupons being listed in numerical order, so that a considerable amount of time is taken up in sorting all the coupons received from the branches for any particular issue into numerical order. On the due date the coupons are presented for payment at the house indicated thereon. It is unusual for payment to be made at once, since most

issuing houses prefer to give a receipt for coupons presented and to claim a day in which to examine the articles. Accordingly, payment is generally received on the day following the due date. A banker's payment or a cheque will be handed to the presenting bank covering the total amount of coupons presented less any returns on account of wrong due date, mis-sorts, and defaced coupons.

These payments are cleared through the special waste book written up by coupon department in a similar manner to the system employed in the new issues department. It follows that the bulk sums received by coupon department cannot be allocated to the branches on the same day, and in order to overcome this difficulty the funds are credited to an account in the house accounts ledger styled Coupon Department Account. In order to distribute the amounts to the branches, coupon proceeds slips are filled in for each account at a branch. These slips are drawn on the house account at head office, and sent to the branches for the credit of their customers, income tax having been deducted from the amount received on their behalf. The branches credit their customers with the proceeds, and remit the slips in the clearing to head office, after marking off the relative entries in the journal.

For income tax return purposes, a voucher is handed to customers when income tax has been deducted from the proceeds of coupons collected. This applies whether the tax was deducted by the presenting bank or by the agent paying the coupons. Such vouchers contain the particulars as given on page 114.

There are three types of coupons generally distinguished in banking procedure. First, the type of coupon with which the various examples previously given have been concerned, the sterling coupon; secondly, there is the coupon payable in a foreign currency, and thirdly the

coupon payable in either sterling or another currency at the holder's option. When coupons are remitted in foreign currencies they are dealt with by overseas branch,

| LOMBARD BANK LIMITED   |  |             |    |
|--|--|-------------|----|
| CREDIT Account of .....<br>Proceeds of..... <i>City of Hamilton</i> $4\frac{1}{2}\%$ .....Coupons.....   | Barrow.....<br><i>Arthur Maynard</i> ..... | Branch..... |    |
| due ... <i>1st June</i> , 19 ....  | Amount. .                                  | £           | s. |
| We hereby certify that Income Tax as shown has been deducted by us from the amount of the above-mentioned Coupons, or that the amount was received by us <i>less</i> Income Tax.   | Tax Deducted. .                            | 22          | 10 |
|  | Commission .                               | 5           | 12 |
|  | Net. .                                     | £ 16        | 17 |
|  |  | 6           | 6  |
| <div style="display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: center;">             .....<br/>             .....<br/>             .....           </div> <div style="font-size: 2em;">}</div> <div style="text-align: center;"> <i>Managers.</i> </div> </div> |  |             |    |
| <b>TO BE SIGNED BY CLAIMANT</b>  |  |             |    |
| I hereby declare that the Coupons within-mentioned relate to Stocks which are my own property, and that the Bonds from which the Coupons were taken are in the possession of.....  |  |             |    |
| <div style="display: flex; justify-content: flex-end; align-items: flex-end;"> <div style="text-align: right; margin-right: 50px;"> <i>Signature</i>.....<br/> <i>Date</i>.....19 ..           </div> </div>   |  |             |    |

who advise the branches at what rates the coupons have been collected.

Coupon department collects many other proceeds for branches than those represented by coupons. Drawn bonds, colonial and foreign dividends, securities for conversion, exchange, and renewal, and life policies, are a few of the miscellaneous articles which pass through this department.

## CHAPTER X

### BRANCH ORGANIZATION

THE successful operation of the branch system in any enterprise must always depend upon efficiently organized accounting methods. When banking is the enterprise under review, for obvious reasons even greater reliance is placed on the accurate transmission of branch entries.

Under any system of branches, returns to head office necessarily play an important part in co-ordinating the individual units into a smoothly running whole. When banking first began to take on the aspect with which we are all so familiar to-day, branches were scarcely contemplated. With the growth of the mercantile community, tentative suggestions were put forward as to the possibility of establishing a branch office in London or another of the large towns. It soon became evident that the country was prepared to welcome these branches, and the movement reached its peak recently, when every village of any size in England and Wales boasted of its bank.

The opening of a new branch in the early days of banking was the signal for considerable ceremony, and elaborate were the plans for its observance. It was customary then to keep duplicate books of record at head office, even the ledger accounts being subject to this treatment. The rapid extension of the branch system effectively rendered this duplication of entries impossible of fulfilment. The logical course was adopted of relying on summarized figures from the branches rather than individual transactions, and the branch return was not

long in making its appearance. With the increasing duties undertaken by banks so the number of returns grew, until to-day the number of branch forms is indeed formidable. Many of these are of a specialized character, designed to be of assistance in formulating the policy of a bank rather than part of its integral book-keeping scheme. These do not concern us in this work, and we will confine our investigation to those returns which summarize the everyday work of a branch.

## REMITTANCES

A considerable proportion of the ordinary routine work at a branch bank is taken up by the collection and payment of cheques. Taking the collection of customers' cheques first, some idea of the procedure involved has been outlined in the chapter on the clearing system, but it is necessary here to examine more closely the settlement of remittances between a branch and head office.

When the branch entries have been made, either by machine or by hand, in the waste book, the articles are handed to the remittance clerk, whose task it is to list the cheques on appropriate forms for each clearing. Thus, in the case of town clearing remittances, all vouchers drawn on Barclays Bank will be listed on a separate form, and the total for that bank carried to a summary sheet on which the names of all the town clearing banks appear. This process is repeated until all the town clearing cheques have been listed, at which point a total can be obtained for the complete town clearing remittance, and this figure is taken to the remittance summary. Similar methods are followed when dealing with the other clearings and the totals are all carried to the summary, a specimen of which is given on page 117.

The Scotch and Irish clearing is concerned with those

# REMITTANCE SUMMARY

| Branch         | Total    | Town<br>Clearing | Walks   | Country<br>Clearing | Scotch<br>and<br>Irish | Metro-<br>politan<br>Clearing | Bank<br>Notes | Country<br>Notes |
|----------------|----------|------------------|---------|---------------------|------------------------|-------------------------------|---------------|------------------|
|                | £ s. d.  | £ s. d.          | £ s. d. | £ s. d.             | £ s. d.                | £ s. d.                       | £ s. d.       | £ s. d.          |
| Highbury . . . | 573 10 4 | 101 5 8          | 10 7 2  | 301 - 1             | 5 8 11                 | 155 8 6                       | - - -         | - - -            |

cheques drawn on banks in Scotland and Ireland; head office remits these articles direct by post and credits the branches on receipt of proceeds. A branch does not remit bank and country notes to head office daily, but according to the surplus available. The soiled bank notes are presented by head office to the Bank of England for cancellation and credit in account, but should the bank deem any of the notes not sufficiently soiled to warrant cancellation the presenting bank must re-distribute them.

The total of the remittance summary must agree with the total of payments to credit for the day, less the amount of cash, and the figures for house cheques, and cheques cleared through the local exchange or clearing house. When the remittance total has been balanced the amount is entered, under the heading of head office remittances, on the transfer sheet that a branch sends to head office each day. The effect of this entry is to inform head office of the amount a branch is debiting its head office account in the general ledger on account of remittances.

The remittance summaries are sorted in branch order at head office, and the totals are balanced in sections. It is obvious that the total of the amounts debited to the various clearings should agree with the sum of the totals the branches are debiting head office. If an error has been made in transferring the figures to the remittance summary at any branch, it will be revealed by this method of checking, and the correct amount can be ascertained on reference to the relative clearing list. As a further check on the remittance totals, all the clearing departments balance the total of the summaries sent with the vouchers by each branch with the total of the amounts debited to them on the remittance summaries. The branches are then credited in account at head office as responding entries to their debits.

We have explained the transfer sheet entries for London remittances, but there are other important entries communicated daily by a branch to head office. For example, the clearing each branch receives from head office is the subject of a credit to head office on the transfer sheet. It will be recalled that the country clearing settlement in London does not take place until two days after the cheques have passed through the clearing house. There is a special suspense account at the City office to contain such entries pending receipt of the branch entries.

A branch, therefore, agrees the cheques sent down from head office. This is done by machining the amounts and agreeing the total thus obtained with the sum of the daily cash sheets, on which the details of the cheques are entered. This amount is advised to head office on the London letter as a separate entry, and also contained on the transfer sheet as a credit to the head office account.

Incorporated in the total of remittances from branches will be found an entry on account of branch cheque remittances. These remittances consist of cheques drawn on branches of the bank other than which they are paid in for collection; head office is debited by the remitting branch and credited by the branch on which a cheque is drawn. Frequently, it is necessary to remit cheques drawn on other branches direct, either because the amount is large or on account of special circumstances. Such items are advised on the transfer sheet by the remitting branch, and debit entries are passed to the head office account. The branch receiving these items credits head office, provided they are in order, and in this way the settlement is made through head office, since the amounts a branch is crediting or debiting the head office account in respect of inter-branch remittances must always be incorporated on the transfer sheet. From these sheets, head office is able



to set off a credit from one branch with a debit from another, since the name of the other branch concerned is also included on the transfer sheet. To ensure greater clarity an example is appended showing how these inter-branch remittances are set out—

## INTER-BRANCH REMITTANCES

BARROW

..... 19..

| <i>Cr.</i>       |              | Branch      |              | <i>Dr.</i>      |
|------------------|--------------|-------------|--------------|-----------------|
| <i>£</i>         | <i>s. d.</i> |             |              | <i>£ s. d.</i>  |
| 246              | 8 2          | Piccadilly, | Manchester . | 67 2 8          |
|                  |              | Sheffield   | . . .        | 87 4 9          |
|                  |              | Dewsbury    | . . .        | 5 - -           |
| 9                | 6 2          | Bognor .    | . . .        |                 |
| <u>£255 14 4</u> |              |             |              | <u>£159 7 5</u> |

It will be seen from the first entry that Barrow Branch has received from Piccadilly branch cheques to the amount of £246 8s. 2d., with which amount it credits head office. The transfer sheet compiled by Piccadilly will have a corresponding debit entry against the name of Barrow. Conversely, with the second entry on the specimen sheet Barrow has remitted cheques to Manchester amounting to £67 2s. 8d. It debits the head office account with that amount, while Manchester will respond by crediting head office and advising to that effect on its transfer sheet.

One other class of remittance appears on the transfer sheet, namely, agency transactions. These arise, among other causes, from customer's credits received by branches for other banks, and from customer's credits received by other banks for the said branches. The operation of agency entries will be fully investigated in a later chapter,



of remittances, but yet are settled by means of the head office account. In order to convey some impression of the type of transaction to be found evidenced by entries in the head office account, a short list of items will be found in the specimen weekly state.

### WEEKLY STATE

The head office account is agreed weekly and a document called the Weekly State is dispatched to head office by each branch. As indicated by its title, this return reveals the state of account between head office and a branch, and it deals with all the entries passed by a branch to the debit or credit of head office. The remittance figures appear on the state in summarized form, since the transfer sheet contains the more detailed entries, but other transactions must be specified in order that they may be compared with the corresponding entries at head office. These returns are handled by states department, and the balances are agreed with the balances outstanding in the branch accounts at head office. From what has been written about the system of responding entries it follows that the omission on the part of a branch or a head office department to respond to an original entry will throw the balancing of the weekly states out, and it is necessary for states department to communicate with the branch or department concerned as to the reason for the absence of the entry. This department posts its entries in the branch accounts from the transfer sheets in connection with remittances, from the head office letter in regard to such items as bankers' payments, and from slips passed by head office departments in regard to special collections, stock bought and sold, etc.

We have mentioned the head office letter in the preceding paragraph and this requires an explanation. In

some banks it is the practice to require the branches to send a daily state to head office, containing full particulars of all operations on the head office account. When used in this form, the daily state is really a combined transfer sheet and head office letter. The disadvantage of this system lies in the fact that different departments at head office must have access to the figures in order to balance such items as drafts drawn, bankers' payments, etc., and to note the acknowledgments by branches of the receipt of stock, coupons, etc., sent down to them by the departments concerned. Where the system of having separate transfer sheets and head office letters is adopted, the latter contains a variety of information.

In the first place, specie received or dispatched is entered on the letter, and chief cashier's department will deal with these figures at head office. Any drafts drawn on head office issued must be specified in full detail on the letter, and the same applies to bankers' payments issued. All advices for the credit of city offices' customers must also be listed; such advices may be on account of application, allotment, or call money in respect of new issues of capital, or they may be payments to credit by multiple shops where the main account is kept in London, etc. Lastly, all bills domiciled at head office by branches must be entered on the head office letter. This last item mainly concerns the big provincial branches whose commercial customers are granted documentary credits. Bills are drawn under these credits on the various branches, and the latter have powers to domicile them payable at head office.

It is clear that the entries passed by the branches in connection with all the transactions enumerated above will be to the credit of head office account. A summary, therefore, is attached to the head office letter incorporating

the totals of amounts entered under the separate headings in the following manner—

| HEAD OFFICE LETTER               |                 |
|----------------------------------|-----------------|
| BARROW                           | 23rd Mar., 19.. |
| Particulars                      | Amount          |
|                                  | £ s. d.         |
| Drafts Issued . . . . .          | 148 6 2         |
| Bankers' Payments . . . . .      | 24 9 8          |
| Bills Domiciled . . . . .        | 1,601 18 7      |
| City Office Advices . . . . .    | 9 - 5           |
| Total credited to H.O. Account . | £1,783 14 10    |

It is now possible to give some idea of the entries appearing on the weekly state. The previous week's totals and balance are placed at the head of the account, and then follow the daily credits and debits on account of remittances, etc. The transfer sheet totals appear on both credit and debit sides of the head office account, the head office letter total must always appear on the credit side, and items of a special nature may figure on either side. On page 125 is a specimen weekly state, containing most of the ordinary transactions undertaken at any branch.

## CASH RETURNS

In most banks a very complete system of cash returns is enforced, partly to avoid loss, and partly to ensure that the bank's specie reserve is equitably distributed throughout the country. Mistakes in cash transactions cannot be avoided, but all "overs and shorts" must be immediately advised to head office. The question of adequate supplies of cash is solved to a great extent by the chief

## WEEKLY STATE

HEAD OFFICE ACCOUNT

BARROW BRANCH

19..

| Date    | Particulars  | Debit    |    | Credit   |    | Balance  |    |
|---------|--|----------|----|----------|----|----------|----|
|         |  | £        | d. | £        | s. | £        | d. |
| 19..    | Brought forward  |          |    |          |    |          |    |
| Mar. 23 | From Transfer Sheet  | 576,289  | 17 | 411,759  | —  | 164,530  | 17 |
|         | " H.O. Letter  | 27,408   | 6  | 11,805   | 3  |          | 8  |
| 24      | " Transfer Sheet   |          |    | 1,783    | 14 | 178,350  | 5  |
|         | " H.O. Letter  | 18,642   | 12 | 9,804    | 3  |          | 8  |
|         | " H.O. Letter  |          | 1  | 56       | 4  |          |    |
|         | £400 Cavendish Ord. Shares sold at par—<br>Account: H. Snaith                  | 400      | —  |          |    | 187,532  | 10 |
| 25      | From Transfer Sheet  | 6,004    | 16 | 19,266   | 15 |          | 3  |
|         | " H.O. Letter  |          | 10 | 1,924    | 5  | 172,346  | 6  |
| 27      | " Transfer Sheet   | 17,362   | 1  | 12,444   | —  |          | 11 |
|         | " H.O. Letter  |          | 1  | 929      | 17 | 176,334  | 9  |
| 28      | " Transfer Sheet   | 12,077   | 16 | 22,649   | 11 |          |    |
|         | " H.O. Letter  |          | 5  | 77       | 3  | 156,685  | 10 |
|         | Special Collection from Bill Department  |          |    | 9,000    | —  |          | 10 |
| 29      | From Transfer Sheet  | 29,847   | 19 | 12,751   | 6  |          |    |
|         | " H.O. Letter  |          | 8  | 1,861    | —  |          |    |
|         | 500 Meritt, Drew & Co. Ord. Shares purchased at 18s. 6d.—Account: James Watney |          |    |          |    | 171,458  | 12 |
|         | Totals   | £688,033 | 10 | £516,574 | 17 | £171,458 | 12 |
|         |  |          | 6  |          | —  |          | 10 |

cashier's department instructing branches with a surplus to remit a certain proportion to other branches less fortunately placed. Alternatively, if direct arrangements can be made, we have already seen that some branches remit surplus notes to head office.

All inter-branch or branch and head office remittances of cash must be referred to in the head office letter, in order that a check may be kept on the movements. Apart from this, most banks require branches to submit a weekly cash statement containing full details of the supply on hand. In addition, there is a separate specification attached to the weekly abstract of accounts. The former is for the use of chief cashier's department, and the latter for chief accountant's department. Taking the weekly cash statement as the more conclusive return, the requirements are set forth on the next page.

### **ABSTRACT BALANCE OF THE GENERAL LEDGER**

Branch entries so far described in this chapter have been mainly confined to the head office account, and it is necessary at this stage to deal with the numerous other transactions giving rise to general ledger entries. The general ledger at a branch is a less complex record of banking operations than that of the city office, described in an earlier chapter. From the description of the city office general ledger, many of the branch accounts will be recognized, and a short explanation is included after the specimen abstract concerning the entries peculiar to a branch.

The various ledgers at a branch are balanced weekly and the summations are carried to the general ledger accounts. An abstract of the balances of these accounts is then sent to head office, setting out the debtors to the branch on the one hand, and the creditors on the

other. To avoid unnecessary repetition the particulars of the general balance of cash on hand are omitted from the example: the total, of course, figures among the assets of the branch. The example of a weekly abstract shown on the next page reflects all the banking operations that a branch may be called upon to perform.

Taking the left hand side of the abstract first, head office account has been rendered familiar to the reader

## WEEKLY CASH STATEMENT

## BARROW BRANCH.

Cash on hand at the close of business ... 19....

|                 |               | £     | s. | d. | £       | s. | d. |
|-----------------|---------------|-------|----|----|---------|----|----|
| Bank of England | 10s.          | 3,210 | -  | -  |         |    |    |
| "               | £1            | 4,925 | -  | -  | 8,135   | -  | -  |
| "               | £5            | 1,760 | -  | -  |         |    |    |
| "               | £10           | 1,980 | -  | -  |         |    |    |
| "               | £20           | 440   | -  | -  |         |    |    |
| "               | £50           | 1,500 | -  | -  |         |    |    |
| "               | £100 and over | 700   | -  | -  | 6,380   | -  | -  |
| Sovereigns.     |               | 150   | -  | -  |         |    |    |
| Half-sovereigns |               | 200   | -  | -  |         |    |    |
| Silver          |               | 5,825 | 18 | -  |         |    |    |
| Copper          |               | 256   | 17 | 2  |         |    |    |
| Postal Orders   |               | 25    | 17 | 9  | 6,458   | 12 | 11 |
| Total           |               |       |    |    | £20,973 | 12 | 11 |

## SURPLUS

|                           | £     | s. | d. | Bank of England 10s. and<br>£1 Notes. Totals for week. |
|---------------------------|-------|----|----|--|
| Bank of England Notes 10s | 1,010 | -  | -  | Remitted to H.O.. £1,000                               |
| " " £1                    | 925   | -  | -  | " Branches 500   |
| Sovereigns                |       |    |    | Total . . 1,500  |
| Half-sovereigns           |       |    |    | Received from H.O. <u>nil</u>                          |
| Silver                    | 1,225 | 18 | -  |  |
| Copper                    |       |    |    |  |



## BARROW BRANCH

ABSTRACT BALANCE FOR THE WEEK ENDING . . . . . 19....

| <i>Debtors to the Branch</i>                    | <i>£</i>          | <i>s.</i> | <i>d.</i> | <i>Creditors of the Branch</i>           | <i>£</i>          | <i>s.</i> | <i>d.</i> |
|---|-------------------|-----------|-----------|--|-------------------|-----------|-----------|
| Head Office . . . . .                           | 265,927           | 8         | 1         | Head Office . . . . .                    |                   |           |           |
| Country Agents . . . . .                        |                   |           |           | Bills for Collection . . . . .           | 3,224             | 6         | 7         |
| Bills Receivable . . . . .                      | 3,224             | 6         | 7         | Current Accounts Creditor . . . . .      | 798,024           | 4         | 8         |
| Bills Discounted . . . . .                      | 25,849            | 17        | 5         | Deposit Accounts . . . . .               | 345,662           | -         | 9         |
| Loan Bills and Promissory Notes . . . . .       |                   |           |           | Deposit Receipts . . . . .               |                   |           |           |
| Past Due Bills . . . . .                        | 3,492             | 1         | 6         | Accepted Bills Account . . . . .         | 1,723             | 19        | 11        |
| Current Accounts Overdrawn . . . . .            | 827,001           | -         | 10        | Foreign Credits, etc., granted . . . . . | 9,446             | -         | 8         |
| Short Loans . . . . .                           |                   |           |           | Adjusting Account of Interest . . . . .  |                   |           |           |
| Accepted Bills Payable Account . . . . .        | 1,723             | 19        | 11        |  |                   |           |           |
| Foreign Credits, etc.—Payable Account . . . . . | 9,446             | -         | 8         |  |                   |           |           |
| Bank of England . . . . .                       |                   |           |           |  |                   |           |           |
| Stamp Account . . . . .                         | 300               | 18        | -         |  |                   |           |           |
| Bank Premises . . . . .                         |                   |           |           |  |                   |           |           |
| Cash on hand as specified below . . . . .       | 15,462            | 1         | 9         |  |                   |           |           |
|   | <b>£1,152,427</b> | <b>14</b> | <b>9</b>  |  |                   |           |           |
| Assets . . . . .                                |                   |           |           | Liabilities . . . . .                    |                   |           |           |
| Incidental Charges . . . . .                    | 1,422             | 15        | -         | Discount Account . . . . .               | 302               | 1         | 10        |
| Salaries . . . . .                              | 2,402             | 18        | 11        | Interest Account . . . . .               | 10                | 7         | 6         |
| Interest Account—No. 1 . . . . .                | 297               | 4         | 2         | Commission Account . . . . .             | 149               | 6         | 9         |
| " —No. 2 . . . . .                              | 2,080             | 6         | 10        | Postages Account . . . . .               | 6                 | -         | 4         |
| " —No. 3 . . . . .                              |                   |           |           | Rent Received Account . . . . .          | 82                | 10        | 8         |
| Rent Received Account . . . . .                 |                   |           |           |  |                   |           |           |
|   | <b>£1,158,630</b> | <b>19</b> | <b>8</b>  |  |                   |           |           |
|   |                   |           |           |  | <b>£1,158,630</b> | <b>19</b> | <b>8</b>  |

by this time, but country agents account requires a brief note by way of explanation. When a cheque or bill is remitted direct to an agent for payment, this account is debited with the amount of the remittance, the entry being reversed when proceeds are received. It is thus a form of suspense account pending advice of payment of direct remittances.

Bills receivable and its contra account, bills for collection, need but little explanation, except for one point. It does not always happen that the balances of these accounts are identical, since it must not be overlooked that the abstract of balances is taken out at the close of business on one particular day each week. Bills of exchange may be held that are payable in a distant town on that day, and they will have gone forward for collection, but proceeds will not be to hand.

Short loans account is chiefly used by large branches to accommodate entries in connection with special loans to provincial stockbrokers. It must be pointed out at this stage that the return of outstanding balances is designed to cover all the transactions that a branch, however large, may be called upon to undertake. It does not follow that the majority of branches require such an elaborate form; in fact there may be very few branches which consistently show operative general ledger accounts as outlined.

Bank of England is yet another account that is strictly limited in operation. Branches using this account are confined to those towns where there is a branch of the Bank of England. It is the practice for such branches to maintain a balance at the Bank of England branch, and this enables the local clearing house to follow a similar procedure for the settling of differences as obtains in London. Another important advantage gained by maintaining

this balance, concerns the supply of notes and coin. The larger branches by drawing on their balances at the Bank of England can obtain any note requirements for themselves and the smaller branches in the district, thus obviating the necessity of sending supplies from London. The balance of this account is agreed every week with the pass book issued by the Bank of England.

Stamp account is used for debiting cheque books when ordered, the account being credited when supplied to a customer. The cheque books on hand are agreed periodically with the general ledger balance.

Bank premises account is debited with the initial outlay in connection with the building of the branch until this amount is extinguished by a head office entry; also the cost of extensive alterations will be debited to this account. Needless to say, this account will be employed only in cases where a considerable sum is involved; trifling expenditure will be debited to incidental charges account.

Incidental charges account is debited with such outgoings as postages, rates and taxes, telephone, clearing, etc. When this account is ruled off every half-year, the amount of postage stamps must be brought in on the credit side, before the debit balance is ascertained. The final balance is wiped off every half-year by passing a debit to head office and a credit to this account. Head office, of course, includes all such half-yearly entries advised by branches on the debit side of the profit and loss account of the bank.

Rent received account is credited with all rents received on account of bank property which has been let, and where there is a separate assessment, debited with rates and taxes, repairs, decorations, etc., payable by the bank.

The right hand side of the abstract calls for little comment, as it consists chiefly of contra accounts.

In connection with the bill and foreign credits accounts, separate ledgers are kept where the transactions are recorded under the name of the particular customer. The balances of these ledgers are taken out and agreed with the respective general ledger balances.

Discount, commission, interest, etc., is credited to the appropriate accounts, and the balances are transferred to head office half-yearly, in a similar manner to that already outlined in connection with incidental charges.

The foregoing illustrates the principles directing the organization of branch banking in this country, but it is by no means a complete record of the co-operation between branches and head office. The returns indicated in this chapter are regarded as essential for bank accountancy, but they are not necessarily helpful to the execution of monetary policy. For this latter purpose, many intricate and distinctive returns are employed, setting out proportions, comparative figures, classes of security, bills, and other assets and liabilities of the bank. Co-ordination between the separate units of a bank must always be the keynote of profitable utilization of its resources, and this cannot be achieved without the most complete system of decentralization.

## CHAPTER XI

### AGENCY TRANSACTIONS

ONE of the salient features of British banking is the co-operation that exists in connection with agency transactions. More remarkable, perhaps, is the fact that although one bank will act as agent for another, it does not diminish the intense competition under which modern banking is conducted.

Recently, a new scheme for the settlement of certain agency transactions has been put into force, necessitating the creation of a new banking document, the agent's claim voucher. In view of the fact that we cannot trace any other description of this innovation, its use will be outlined in detail.

It is the practice for a branch of a clearing bank to receive articles for the credit of another bank's customer, when the other bank is not represented in the town or village. This system has much to commend it, since operated on a *quid pro quo* basis it saves the various banks the expense of running a branch or agency for the purpose of receiving credits for other branches, and also it is more convenient for the customers. The articles paid in for collection under this arrangement are remitted to the head office of the branch bank concerned in the ordinary way, but the credit slip made out by the person handing the cheques in for collection is sent direct to the branch of the bank where the account is kept. Accompanying this credit slip is an agent's claim voucher, with the details of the credit listed on the reverse side. The amount of the voucher is credited to the head office account, and

specified on the transfer sheet under the heading of the particular agent. Thus the branch debits head office in the remittances and credits it on the transfer sheet, the result being no change in its position. When more than one credit is sent to the same branch of a bank on the same day, one agent's claim voucher only is forwarded, the various credits being listed on the back, and the total being placed on the transfer sheet.

The following is an example of an agent's claim voucher used in connection with credits received—

|   |                   |              |    |
|---|-------------------|--------------|----|
| NOT TO BE PASSED THROUGH THE CLEARING HOUSE   |                   |              |    |
| METROPOLITAN BANK LTD.  |                   |              |    |
| 99 LOMBARD STREET, LONDON   |                   |              |    |
| <b>AGENT'S CLAIM VOUCHER</b>  |                   |              |    |
|   |                   | 5th April 19 | .. |
| To ..   | Lombard           | BANK         |    |
| ..  | Manchester...     | BRANCH       |    |
| Receive from our Head Office the sum of <i>Two hundred pounds seven shillings and sixpence</i> on account of CREDITS RECEIVED per slips enclosed and specified on the back of this voucher. |                   |              |    |
| METROPOLITAN BANK LTD.  |                   |              |    |
| <u>£200 : 7 : 6</u>   | Barrow .. Branch. |              |    |

When an agent's claim voucher is received by a branch on account of credits for a customer paid in to another bank, it is remitted to head office and charged in the remittance total. A separate charge is made containing details of the name of the other bank concerned against each amount listed on the agent's claim sheet. In some banks it is the practice to incorporate such totals on the country clearing summary, and to send the vouchers to

this department at head office. Whichever method is adopted head office must present specially to the head office of the other banks concerned the various vouchers received each day. Settlement between the head offices is not effected until the day following presentation, in order that the amounts may be agreed with the transfer sheet entries from the branches.

A second transaction that is now settled by agent's claim voucher occurs when a bank owes a balance on account of local exchange. A local exchange is an expedient adopted in those towns where there is no clearing house, and a succinct definition would state that it endeavours to follow the principles of a clearing house without the actual building. Balances are due between the various members of the local exchange on account of local cheques cleared that day, and whereas heretofore these transactions were settled by a banker's payment, now an agent's claim voucher is issued. Any cheques returned unpaid after settlement has been effected are paid for by a further voucher. The local exchange voucher is similar to the example given before, with the substitution of the words "local exchange" for "credits received, etc."

The third and last transaction involving an agent's claim voucher concerns the practice of one bank drawing a draft on another. Arrangements exist whereby one bank can draw on another under advice; particularly does this apply as between a non-clearing bank and its clearing agent. When a branch draws a draft on another bank, an agent's claim voucher is attached to the advice, and head office is credited on the transfer sheet. Conversely, when another bank advises drawing on the branch, the latter will receive an agent's claim voucher. This voucher is passed through the remittances and the funds credited to inter-branch and agent's draft account in the interim

before the draft is presented for payment. This account is debited on payment of the draft.

This completes the scope of the agent's claim voucher, but there are other important transactions settled by alternative methods that require explaining.

First, there are direct remittances to be considered. This is the remitting of a cheque, bill, etc., for special collection to another bank. When a branch remits a cheque to another bank direct, it debits the amount of the article to country agent's account, and when advice of proceeds is received from London that account is credited. On the other hand, when a branch receives a direct remittance from another bank, if the article is in order, a banker's payment drawn on head office is made out. The distribution and settlement of these payments is carried out in London, so that a branch will send any payment it issues to its head office, for the latter to hand it to the head office of the remitting bank.

In the event of a direct remittance being returned unpaid no entries are passed, with the exception of a reversing entry in the remitting branch's country agents' account.

When cheques are remitted to Scotch and Irish banks the procedure is again varied. The branch remitting such articles makes out an agent's debit slip, which is included in the remittances for that day, and thus has the effect of debiting head office. Head office, in turn, receives payment from the London office of the bank on which the cheques are drawn. The specimen given on page 136 shows the particulars incorporated on these slips.

### CREDIT SLIP CLEARING

A novel plan was introduced two years ago for the facilitating of the settlement of trade debts. Under this



## AGENT'S DEBIT

| £             | s.        | d.       | ..... <i>Barrow</i> ..... .. Branch ...15 <i>April</i> 19.... |             |
|---------------|-----------|----------|---|-------------|
|               |           |          | DEBIT Head Office   |             |
|               |           |          | Name of Agent ... <i>Scotland Banking Co.</i> .....           |             |
|               |           |          | Branch  | Particulars |
| 1,068         | 10        | 4        | Perth   | J. Dawson   |
| 9             | 6         | 7        | Aberdeen  | L. Swann    |
| 74            | 2         | 5        | Kirkcudbright   | A. S. Maple |
| <u>£1,151</u> | <u>19</u> | <u>4</u> |   |             |

scheme a company can instruct its bank to pay to the creditor's bank any debt that is outstanding, and thus avoid the expense of issuing and posting a cheque in settlement thereof. The scope of this innovation is limited in extent, owing to the necessity of obtaining the creditor's assent to his account at the bank being credited, but it has proved to be most useful for the payment of wages and the settlement of monthly accounts.

In order to explain the operation of the credit slip scheme, it is perhaps easier if we look at it from the company's point of view. The first step to be taken is to obtain a series of credit slips from the bank, and to fill in the details required. The name and branch of the creditor's bank will be inserted, together with the full name of the creditor and the sum due to him. This procedure is followed with each slip. Having completed the list of disbursements, the company is then required to number each slip and enter the details on a specification, which is made out in duplicate, the original being receipted and returned to the company by its bank when

the slips are paid in for disposal. The last formality to be completed by the company is the writing out of a cheque in favour of its bank for the total amount to be distributed. The cheque is debited to the company's account, and the bank undertakes to deliver the credit slips to the various banks indicated, with the rapidity that a cheque would be delivered. The advantage to the company consists of saving postage and stamp duty on every debt settled, since the Inland Revenue authorities have decided that these credit slips do not attract stamp duty. The company's auditors are satisfied that the debts have been duly paid, if the receipted specification is produced for their inspection.

## CREDIT SLIP

| METROPOLITAN BANK       |         |            |             | Date .. .. 17th Mar. .... 19... |          |          |
|-------------------------|---------|------------|-------------|---------------------------------|----------|----------|
|                         |         |            |             | Branch . . . Barrow ...         |          |          |
| Please credit as under— |         |            |             |                                 |          |          |
| Credit Slip No.         | Bank    | Branch     | Account     | Amount                          |          |          |
| 7                       | Lombard | Manchester | R. Thomas . | £<br>78                         | s.<br>19 | d.<br>11 |

The company employing this method of settling its accounts should obtain the written authority of the creditor, and the banks will supply a standard form on request. The specification that a bank receipts, retaining the duplicate, consists of the details given on page 138.

No objection is raised if the customer desires to incorporate details concerning discount, commission, etc.,

## CREDIT SLIP SPECIFICATION

## ORIGINAL

To.....*Metropolitan Bank Ltd.*.....*Barrow.* . . . Branch.

Please distribute the credit slips attached, as arranged with the recipients. Our cheque for £441 : 2 : - is enclosed.

.....*Smith, Robinson & Co. Ltd.*.....

Signature

.....*17th Mar.* 19.....

Date.

List No.....

| Credit Slip No. | Bank       | Branch     | Recipient           | Amount |    |    |
|-----------------|------------|------------|---------------------|--------|----|----|
| 7               | Lombard .  | Manchester | R. Thomas .         | £      | s. | d. |
| 8               | "          | Newcastle  | Davies Bros. .      | 78     | 19 | 11 |
| 9               | Birmingham | Aston      | Gillespie & Moore . | 9      | 10 | 6  |
| 10              | London .   | Harrow     | Baxter & Co. .      | 27     | 1  | 4  |
| 11              | "          | Cheapside  | Cooks Ltd. .        | 146    | 14 | 5  |
| 12              | "          | Enfield    | Lightfoot Bros. .   | 92     | 5  | 8  |
|                 |            |            |                     | 86     | 10 | 2  |
|                 |            |            |                     | £441   | 2  | -  |

The amounts set forth in the schedule totalling in all £441 : 2 : - have been advised to the Bankers named for the credit of the parties specified.

Date .....*17th Mar.* . . . 19  
.....*For Metropolitan Bank Ltd.*

on the credit slips, since it is the practice to permit the recipients to retain the slips when they have been passed through the books of their bankers.

The entries passed at the branch where a customer takes advantage of the credit slip clearing scheme are extremely simple to follow. The company's cheque is, of course, debited to its account, and the corresponding entry consists of a credit to the head office account on the State.

When the credit slips are received from a customer, they are sorted under individual banks, and listed on a clearing list, which contains similar details to an ordinary remittance sheet. A payment is then made out by the branch in favour of head office for the total amount of credit slips clearing remitted, and sent with the credit slips in the remittance letter to head office. Head office distributes the credit slips to the head offices of the banks mentioned therein, and hands them a payment for the amount due to them. The total of the individual payments should equal the amount of the payment made out by the branches in favour of head office for any one day.

The head office of the branch bank due to receive the credit slip will credit the branch in account and send an advice, with the credit slip attached to the branch. The latter will advise the recipient of the credit to his account, and hand over the relative credit slip, which the creditor should retain for audit purposes.

## CHAPTER XII

### FOREIGN EXCHANGE

THE services rendered by the banks in connection with foreign exchange have been extremely prominent during the period of world depression. To attempt an academic analysis of the operation of the exchanges at the present time is to court disaster, since the kaleidoscopic restrictions and decrees of the more important countries would call for constant revision of any doctrine.

True to its time-honoured occupation of dealing in money, a bank deals in foreign exchange by purchasing debts in foreign currency from those of its customers who are creditors of another country, and selling currency to the debtors of another country. These debts are evidenced by various instruments peculiar to the foreign exchange market, an explanation of which will follow shortly.

In order to be in a position to buy or sell the currency of another country it is necessary for a bank to establish correspondents or agents in every important centre in the world. The relationship between the bank and its agent must be such that it is possible for the former to maintain an account with the latter, which in time of need can be temporarily overdrawn, if adequate cover for certain transactions is not immediately available. Similarly, English banks act as agents for these foreign banks. The accounts which an English bank keeps abroad are known as "Nostro" accounts, and those kept by a foreign correspondent with the home bank are called "Vostro" accounts. Statements of these accounts are usually

sent weekly, and the entries checked by the receiving bank.

The principle of agency accounts having been outlined, the various instruments employed in operating on these balances must be discussed, and the following list will be found to be tabulated in order of present day importance.

### TELEGRAPHIC TRANSFER

To call this type of remittance a document is somewhat misleading, since no actual legal document is created by banks when they are called upon to transfer funds from this country to another. The procedure is simplicity itself. On receipt of a request by a customer to effect a telegraphic transfer, a bank will at once send a coded telegram to its agent in the particular centre mentioned, instructing that agent to pay the sum mentioned to the person indicated. From this brief statement the limited scope of this form of remittance is at once apparent. First, the whole system must always depend on the conducting of accounts with these agents abroad, and secondly, a private or semi-private code must be a distinguishing feature of the relations between principal and agent. For these reasons, banks are peculiarly fitted to deal in exchange transactions of this nature, but outside this charmed circle a telegraphic transfer is unsuitable.

The reader will not be surprised to learn that a telegraphic transfer is the dearest form of remittance, in view of what has been said, but it must be remembered that no other method is in force which places the funds at the disposal of the foreign beneficiary on the same day as the order is received in London. The rate for telegraphic transfers is the rate that is more sensitive to present

influences, since it represents the value of one currency in terms of another on any one day.

### **MAIL TRANSFER**

This form of remittance covers a transfer of funds by written advice instead of by cable. Again, the need for an account to be maintained is obvious, but the existence of a code is rendered unnecessary. The cost of a mail transfer always works out cheaper than that for a telegraphic transfer, owing to the fact that the amount will not be debited to the issuing bank's account in the foreign centre until the boat carrying the advice has arrived.

### **DEMAND DRAFTS**

A considerable amount of foreign work at a branch is taken up with issuing foreign currency drafts to customers. The reason for the popularity of this type of remittance lies in the fact that it renders the knowledge of the creditor's bankers unnecessary, whereas with a mail transfer the transaction must be passed between the two banks. These demand drafts bear an impressed stamp similar to cheques; they are addressed to the agent abroad with a request that the draft be paid to the beneficiary and debited to the issuing bank's account. It is the practice for banks to make a nominal charge for drafts under a certain minimum. With amounts in excess of that figure sufficient recompense is forthcoming by a turn in the rate.

It is generally found that the majority of drafts are required on the big foreign centres, such as Paris, New York, etc. Most of the large banks have a considerable number of agents in these centres, and the rota system is frequently employed in order that the business shall be

evenly distributed. Occasionally, a request is made for a draft to be issued on some remote town that no amount of searching will reveal an agent situated. To overcome this apparent deadlock, it is necessary to draw the draft on the nearest large town, and advise the agent to make investigations, if possible, if presentment be unduly prolonged.

The foregoing deals with the three most important types of remittance, and it will be noticed that they are specialized transfers between financial institutions in either country. So far it has been a rich man's hobby, but the poor man is allowed to partake of some of the good things, even though he may be sent to the back-door, and it is necessary to introduce the humble bill of exchange without delay.

### **BILLS FOR SALE OR COLLECTION**

Where no other means of settling international indebtedness exist, it is the practice for the creditor to draw a bill on the debtor, attaching thereto the documents relative to the shipment. Frequently, however, the draft will be clean, and sometimes the debtor may have remitted his bank cheque to the creditor. All these articles find their way to the English banks, either as a collection, or as a sale. In the former eventuality, the bank collects the instruments in a similar manner to ordinary bills for collection; in other words, no assets of the bank are involved, and, provided the customer's instructions are followed, no risk attaches to the transaction. For customers of good standing, however, a bank is prepared to buy the currency represented by these instruments, and a rate will be quoted at which the bank will convert into sterling, placing the proceeds to the credit of the customer's account. This rate varies according to the tenor of the



bill, because interest must be reckoned on the time the bank will be out of the funds, and according to the strength of the customer, since all such sales are negotiated with the usual recourse in the event of dishonour.

The advantage to a customer when a bank agrees to buy his foreign cheque or bill is obvious. If he had failed to interest the bank the funds would not have been at his disposal until some days, or weeks, had elapsed. It may perhaps be noticed that we have not mentioned a transaction concerning the sending of a long bill by an English debtor to his foreign creditor. The reason must be sought in the strength of sterling, since a foreign exporter would always prefer to draw a bill on the importer in sterling, rather than ask the latter to send him a long currency bill.

An overseas branch is an accepted feature of modern banking, and it represents a constantly expanding side of a bank's activities. To this branch all the foreign work of a bank gravitates, and all transactions carried out at a branch must be advised to the apposite department, in order that the necessary entries are passed to the agent's account.

## DEALERS

Speculation on the part of a bank's dealers is sternly discouraged, and it behoves every dealer to balance his deals as quickly as possible. The chief dealer will operate on a major currency, either dollars or francs, and will supervise any particularly large transaction in other currencies. The other dealers will share the various currencies between them, and while not dealing exclusively in their own specialities, they will concentrate as far as possible on those lines. Each dealer has a Position Book in front of him, which is an ordinary ruled sheet

revealing all his deals during the day, and aiding him to ascertain whether he has balanced every sale with a purchase or *vice versa*. Needless to say, the various currencies are separated, and deals in francs will be found on one page, dollars on another, and so on.

It is not always a simple task to balance a sale with a purchase, particularly if rates are erratic, and it may be that cover will take some different form from that of the original deal. In connection with this covering of positions, a foreign exchange dealer<sup>1</sup> had some interesting observations to make when lecturing to members of the Institute of Bankers. He said—

“ . . . now it is by no means necessary that the dealer should cover any particular transaction such as the sale of a cheque or T.T. by an exactly similar transaction. He may cover the sale of a cheque by the purchase of T.T., or he may cover a purchase of a ‘long bill’ in a foreign currency by an outright forward sale of T.T. The exact form of covering is often the source of his largest profit, because by judicious dealing he can very often discover how to get out of perhaps an awkward tangle by dealing in some completely different form of credit instrument or even in a different exchange altogether.” . . . “Within a little he must keep his purchases and sales balanced, but obviously he cannot rely entirely on one customer coming along at the same time as another and each customer wanting to do the opposite thing—one customer wanting to buy cheque on New York and the other customer desiring to sell—one customer wanting to buy T.T. Paris and another wanting to sell T.T. Paris, and each for similar amounts. There must always be a certain short gap between the conclusion of one transaction and the conclusion of the covering operation, but we do not consider that as speculation.”

## FORWARD CONTRACTS

Previously in this chapter we have dealt with spot transactions, but a considerable business is done in forward deals. The object of buying or selling forward is

<sup>1</sup> Mr. H. E. Evitt. See also his books (Pitman).

to avoid the risk that exists from fluctuating exchange rates, between the date of an importer signing his contract and the date on which he has to effect payment. Thus, an importer in this country may buy goods worth £10,000 from an exporter in the United States, and the contract stipulate for payment in sixty days' time. As soon as the contract is ratified the English importer will approach his bankers and request them to sell him forward enough dollars to cover the contract price plus shipping expenses. On completion of the forward deal, the importer is relieved from any anxiety as to the future trend of the dollar, since no matter what happens to the rate in the meantime he can go to his bankers sixty days hence, and claim the dollars he has bought forward in exchange for the agreed amount of sterling. The importer passes the risk on to the banker.

We have noticed, however, that the bank's dealer must always endeavour to set off a sale against a purchase or *vice versa*, so he will not long be content with the position. Either this particular sale of dollars offsets an earlier purchase, or else the dealer must find a seller of forward dollars. Should he be unable to find a seller of forward dollars at a favourable rate, the dealer must have recourse to buying T.T. or mail transfers and allowing his account with the American bank to contain the dollars.

The deals outlined heretofore have been between a bank's dealer and a customer, but it must be obvious that for his cover the former cannot rely on the customer's demands neutralizing each other. In order to preserve his position he must have recourse to the other professional quarters of the market, and such deals are known as "market deals."

At this stage it is necessary to explain briefly the functioning of the foreign exchange market. A similar

air of mystery shrouds this "market" as that surrounding the operations of the discount market, inasmuch as there exists no defined meeting-place or clearing house, but newspapers glibly quote activity or otherwise in the market. The foreign exchange market is conducted almost exclusively by telephone, and consequently the work must be carried out at high pressure.

The most important members of the market are the leading banks and financial institutions, since the sources of demand and supply can be traced to these houses. A considerable waste of time would be occasioned, however, if a bank wishing to dispose of spot dollars had to approach the other banks until it found a buyer, and as time is perhaps the chief element in a dealer's organization, such a position could not for long be tolerated. Accordingly, a group of brokers operate in the market, and in most cases specialize in a particular currency. The brokers act as intermediaries between banks wishing to dispose of currency holdings, and those desirous of acquiring balances. Lest it be imagined that a broker is merely an undesirable intermediary taking an assured brokerage for performing an academic function, it must be emphasized that the numerous deals are carried out at top speed, and a broker must gauge not only the probable trend of rates, but also the extent of the market's resources in any particular currency. A broker may sell dollars to a bank, relying on a known source of supply being able to accommodate the purchaser, but to his consternation that institution may report a shortage. A frantic call round the market will ensue, and the broker may have great difficulty in obtaining the dollars at a profitable rate.

With the foregoing sketch of the activities of the foreign exchange market, we can investigate some of the

book-keeping entries involved by each deal. The dealer's position sheet has been mentioned, and although the exact ruling of this sheet varies with each bank, the following details will invariably be found incorporated thereon—

1. The name of the broker through whom the transaction is passed.
2. The other party to the deal, as communicated by the broker.
3. The rate and amount of each deal.
4. The value date of the deal.
5. The amount of sterling involved.

The dealers themselves have no time for keeping books of account, and beyond the recording of rough details on the dealer's slip that is passed for every transaction, all book-keeping entries are made by departments grouped around the dealers.

When a deal has been completed with a broker, the latter sends round to the bank his contract note, which is at once checked with the dealer's position sheet. It is now imperative that the two contracting parties brought together by the broker for the purposes of the deal get in touch with one another, in order that the purchaser may give the seller instructions as to the transfer of funds. The bank buying francs, for example, will have decided the agent to which it wishes the francs to be transferred, since it has probably run down or overdrawn its account with that institution. On the other hand, the bank selling the francs wishes to arrange with its own agents in Paris to transfer to the buying bank's agent. A written confirmation passes between the two banks after the details of the transaction have been completed, the particulars of which should, of course, agree with the broker's contract note.

A multiple form can now be made out from the vouchers in the possession of the bank originating the deal. The component parts of the multiple form vary in each institution, but it will be generally found that there is a confirmation, a posting slip, the advice to the agent abroad instructing him to receive (or pay), and a copy for filing purposes. The posting slip is utilized for entries in the ledger and the position diary, although in some cases the latter book is written up from the dealer's position sheet.

With every spot deal there are two actual transfers of funds; one takes place in London, and the other in the country whose currency is the subject of the deal. For example, Bank A sells Bank B 50,000 T.T. Paris. By custom of the exchange market T.T. deals on most centres are not actually settled until two days after the contract was made. In this case Bank A receives the equivalent in sterling from Bank B two days later, and credits its Nostro account with its Paris agent. Acting on the instructions received the agent of Bank A in Paris pays on the same day 50,000 francs to the agent of Bank B. It would appear to be the practice in some banks to regard such transactions as forward exchange bought or sold value two days later, and, as such, to pass similar entries to the forward contracts explained hereinafter. Another method is to utilize a form of house account which is debited or credited with the sterling equivalent of the deal on the date it is put through; this account being employed for receiving or paying the proceeds to the other party on the value date.

With forward transactions the following procedure is adopted. Assuming the previous contract to be repeated on a forward basis, and looking at the entries from the point of view of Bank A, at the date of the contract Bank A

will debit forward sales account Bank B, and credit forward exchange Paris sold. When the value date of the deal arrives Bank A makes the following entries: debit forward exchange Paris sold, and credit Nostro account concerned.

The ledgers used for recording these entries have no particular features, and an ordinary ruling would be as given on pages 151 and 152.

The specimen rulings apply only to sales of forward currency. In regard to purchases the entries would be reversed, and the ledger sheets headed purchases. Under some systems of book-keeping the purchases and sales are combined in one account, but the method outlined above would appear to be better adapted to the needs of a large office.

## **HOLD ACCOUNTS**

Many customers of a bank prefer to hold foreign currency on their own account in order to avoid exchange losses, rather than negotiate forward exchange contracts. Broadly speaking, there are two methods of building up a balance of foreign currency held abroad, by outright purchases of T.T. with instructions to the English bank that the amount is to be held on hold account, and secondly, by allowing the proceeds of a bill or cheque for collection to remain at the centre where the article was paid.

Most banks stipulate at the time of receiving instructions to place amounts on hold accounts that the customer signs a declaration agreeing to the deposit being held abroad entirely at his own risk and responsibility. The importance of this clause will be appreciated in these times of unstable banking conditions in most of the countries with large commercial undertakings. Interest is

## FORWARD SALES ACCOUNT—BANK B

| <i>Dr.</i> | Particulars        | Sterling Amount | Value Date   | Rate | Deliveries | Debtor Balance | <i>Cr.</i>  |
|------------|--------------------|-----------------|--------------|------|------------|----------------|-------------|
| 19..       | 50,000 Paris . . . | £ 581           | 19.. June 15 | 86   | £ 581      | £ 581          | <i>d.</i> — |
| May 16     |                    | s. 8            |              |      | s. 8       | s. 8           | <i>s.</i> — |
| June 15    |                    |                 |              |      | 581        | 581            | <i>nil</i>  |

## FORWARD EXCHANGE SOLD—PARIS

| Dr. | Date    | Particulars | Currency | Sterling            | Rate | Value Date      | Currency | Sterling            | CREDITOR BALANCE |                     | Cr. |
|-----|---------|-------------|----------|---------------------|------|-----------------|----------|---------------------|------------------|---------------------|-----|
|     |         |             |          |                     |      |                 |          |                     | Currency         | Sterling            |     |
|     | May 16  | A/c Bank B  | 500000   | f. s. d.<br>581 8 - | 86   | 10..<br>June 15 | 500000   | f. s. d.<br>581 8 - | 500000           | f. s. d.<br>581 8 - |     |
|     | June 15 |             | 500000   | 581 8 -             |      |                 |          |                     | nil              | nil                 |     |





allowed on hold accounts in proportion to the rate received by the bank from its agent in the foreign centre on all deposits, a small profit being generally retained. With a large balance placed on hold account it may be necessary for the whole, or part, of the amount to be earmarked by accounts department, in order that the bank's balance with its agent does not fall below that figure.

The object of a customer instructing the bank to hold currency with its agent abroad for his account is to enable him to be in a position to settle his commitments in that country at any time without being at the mercy of a fluctuating exchange. By purchasing spot T.T. the customer knows exactly what his transactions will cost, and can operate on that basis. By allowing the proceeds of a collection to remain on hold account, the customer is "marrying" a debt due from him with one due to him, the exchange risk element being thus excluded. Amounts on hold account can be withdrawn by T.T., M.T., or by draft, and at any time. A ledger account is kept at the branch of the bank with which the depositor keeps his ordinary account, and it is ruled in a similar manner to the specimen on page 154.

It was seen earlier in the chapter that the dealer's profit consists of the margin between his buying and selling rates, and further that the method of covering a deal may play an important part in the ultimate profit. Before concluding this chapter and the book, it may be mentioned that the banks derive a profit from most currency deals, and it generally accrues to the branch initiating the transaction. This profit is obtained in the difference between the rate charged to the customer and that at which overseas branch advises the branch. An exception to this rule concerns drafts for small amounts, where a flat charge of one shilling is usually imposed

---

Customer ... .. *William Aspinall*

Rate of Interest— $1\frac{1}{2}\%$ 

| Date    | Particulars            | Value<br>Date | Dr.    | Cr.   | Balance | Days | Interest | Statement<br>to<br>Customer | Remarks |
|---------|------------------------|---------------|--------|-------|---------|------|----------|-----------------------------|---------|
| 19..    | T.T.                   |               |        |       |         |      |          |                             |         |
| Apr. 10 | Proceeds of Collection | Apr. 12       | 78625  | 1000  | 1000    | 34   | £ s. d.  |                             |         |
| May 16  |                        | May 16        |        | 78625 | 178625  | 16   |          |                             |         |
| June 2  | Draft                  |               | 178625 |       | 178625  |      |          |                             |         |

owing to the very big turn that it would be necessary to take in the rate to produce even the most nominal of profits.

All profit thus obtained on overseas business is credited to commission account at the time of debiting the customer's account, and, of course, swell the total profits made by the branch and the bank every half year.



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